Pristine.com Presents

Options Trading The Pristine Way

With

Oliver L. Velez

TOOLS AND TACTICS FOR THE MASTER DAY TRADER
Save 20% when you buy all 3
MICRO TRADING TACTICS
SWING TRADING
CORE TRADING TACTICS
OLIVER VELEZ

Founder of Pristine.com, and Author of the best selling book, Tools and Tactics for the Master Day Trader

Copyright 2001, Pristine Capital Holdings, Inc.

Table of Contents

Introduction

Four Styles of Trading

Two Categories of Trading

Tools of the Options Trader

Pristine Method™

Determining Who is Winning

When to be a Bull

When to be a Bear

Counting Your Way to Profits

Pristine Trading Combinations

Pristine Options

Advantages & Disadvantages

Buying/Selling Calls

Buying/Selling Puts

Combo Strategies

Options Pricing

3 Determinants of Price

Time Premium Decay

The Greeks: Assessing Risk

Playing the NASDAQ

Options Disclaimer

It should not be assumed that the methods, techniques, or indicators presented in this book will be profitable or that they will not result in losses. Past results are not necessarily indicative of future results. Examples in this book are for educational purposes only. This is not a solicitation of any order to buy or sell.

"HYPOTHETICAL OR SIMULATED PERFORMANCE RESULTS HAVE CERTAIN INHERENT LIMITATIONS. UNLIKE AN ACTUAL PERFORMANCE RECORD, SIMULATED RESULTS DO NOT REPRESENT ACTUAL TRADING. ALSO, SINCE THE TRADES IN THIS BOOK HAVE NOT ACTUALLY BEEN EXECUTED, THE RESULTS WE STATE MAY HAVE UNDER OR OVER COMPENSATED FOR THE IMPACT, IF ANY, OF CERTAIN MARKET FACTORS, SUCH AS LACK OF LIQUIDITY. SIMULATED TRADING PROGRAMS IN GENERAL ARE ALSO SUBJECT TO THE FACT THAT THEY ARE DESIGNED WITH THE BENEFIT OF HINDSIGHT. **NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN.**"

The authors and publisher assume no responsibilities for actions taken by readers. The authors and publisher are not providing investment advice. The authors and publisher do not make any claims, promises, or guarantees that any suggestions, systems, trading strategies, or information will result in a profit, loss, or any other desired result. **All readers and seminar attendees assume all risk, including but not limited to the risk of trading losses**. Options involve risk and are not suitable for all investors. Prior to buying or selling an option, a person must receive a copy of Characteristics and Risks of Standardized Options (www.cboe.com).

Options Trading can result in large losses and may not be an activity suitable for everyone.

Copyright © 2001 by Pristine Capital Holdings, Inc. All rights reserved. Printed in the U.S. of America. Except as permitted under the United States Copyright Act of 1976, no part of this publication may be reproduced or distributed in any form or by any means, or stored in a database or retrieval system, without prior written permission of the publisher.

Part I

Introduction

Types of Trading

Four Styles of Trading: ***Core; Swing; Guerrilla; Micro***

Which fall into….

Two Broad Trading Categories: ***Wealth; Income***

Two Broad Trading Categories

Wealth Trading Styles

Core Trading

- Weekly Charts
- Weeks to Months

Swing Trading

- Daily Charts
- Days to Weeks

Income Trading Styles

Guerrilla Trading™

- 60 Min. & 30 Min.
- Hours to Days

Micro Trading

- 5 Min. & 15-Min.
- Minutes to Hours

The Pristine Philosophy

Pristine Tip:

The Pristine Trading Philosophy calls for a trader to have 1) a *Wealth* Building trade and 2) an *Income* Producing trade on….

At All Times!

The Pristine Options Tools

Tools of the Options Trade

Charting Tools: *Color-coded charts & Volume displayed in Candlestick form*

Technical Tools: *20-period 'simple' moving average; Bollinger Bands; CCI(5)*

Options Tools: *Direct-Access Executions; Options Pricing Screen; Options Analytics*

Candlestick Charts w/ Volume

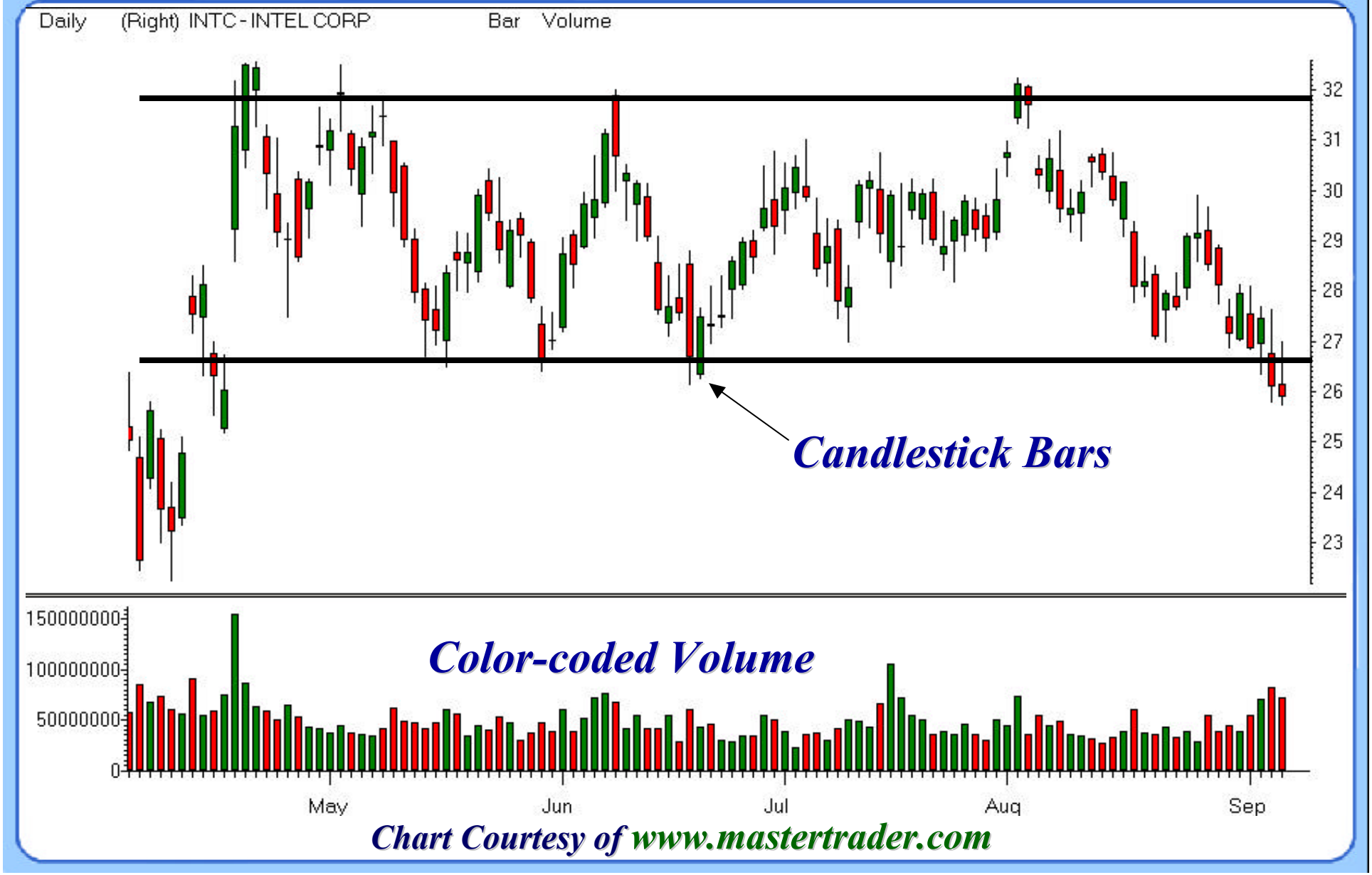


Chart Courtesy of www.mastertrader.com

Bollinger Bands w/ 20MA

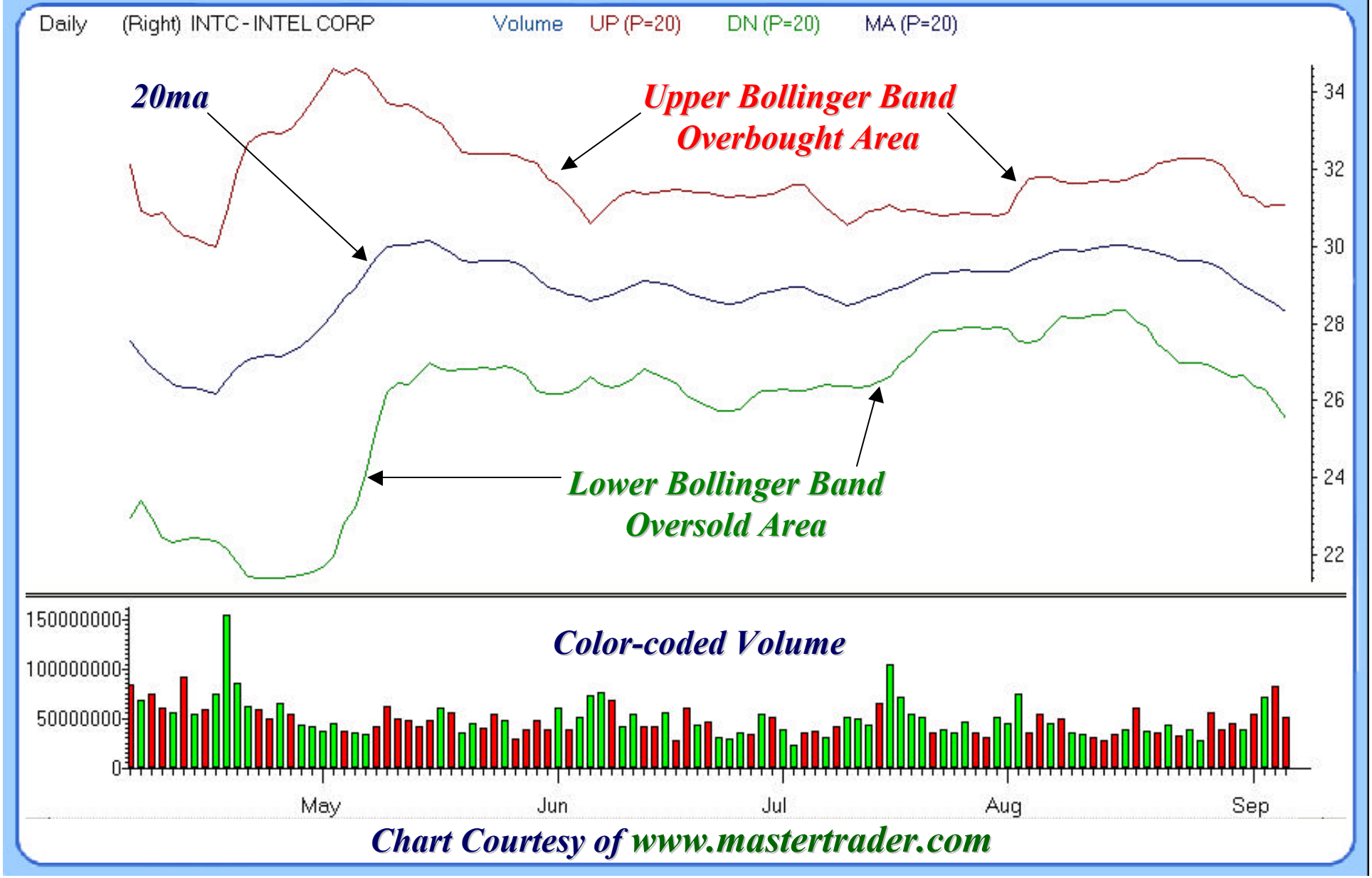
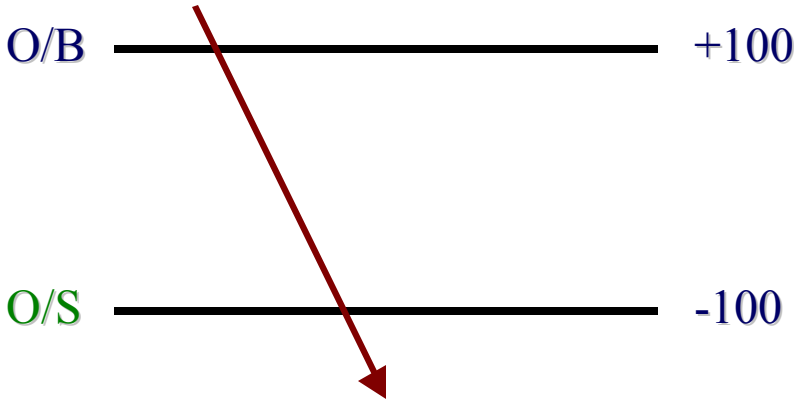


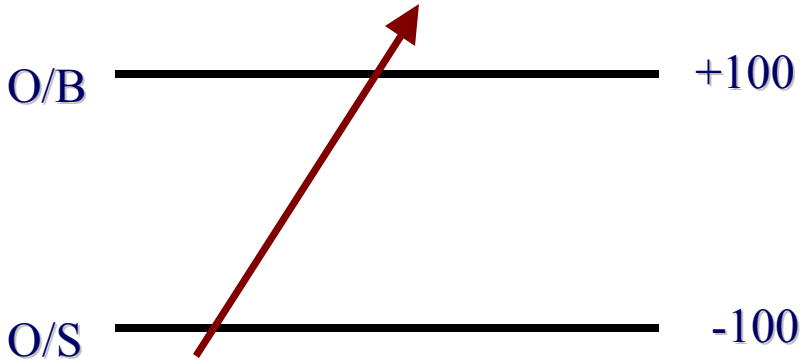
Chart Courtesy of www.mastertrader.com

Commodity Channel Index (CCI-5)

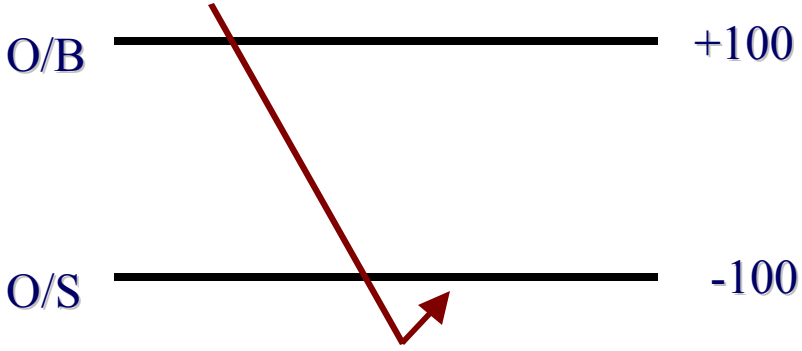
Anticipatory CCI(5) Buy Signal



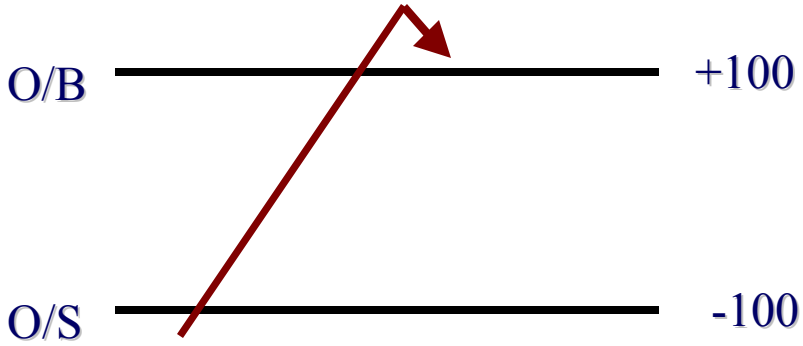
Anticipatory CCI(5) Sell Signal



Pristine CCI(5) Buy Signal



Pristine CCI(5) Sell Signal



Note: Pristine looks for buy signals in uptrends & sell signals in downtrends.

Options Technical Tools

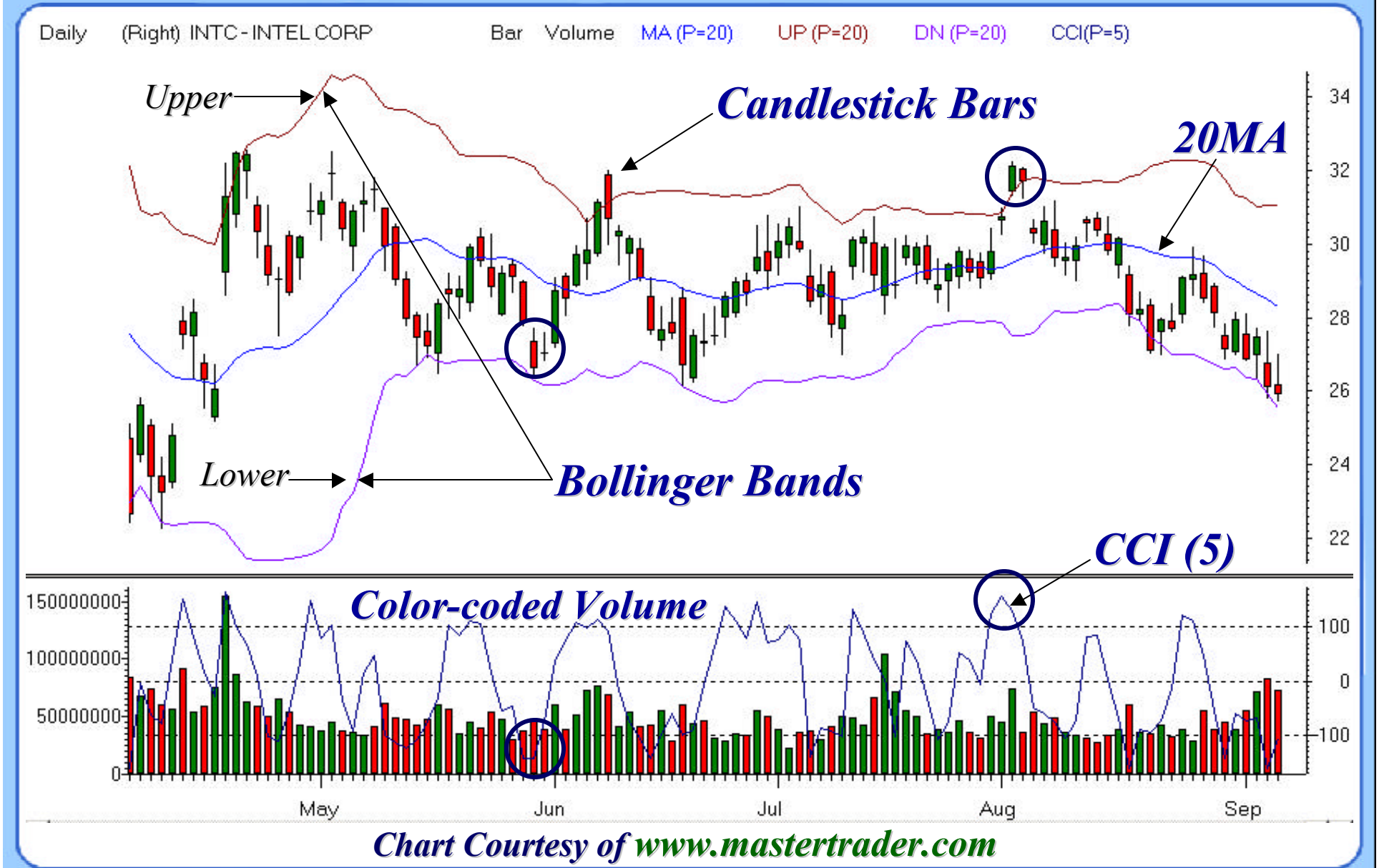


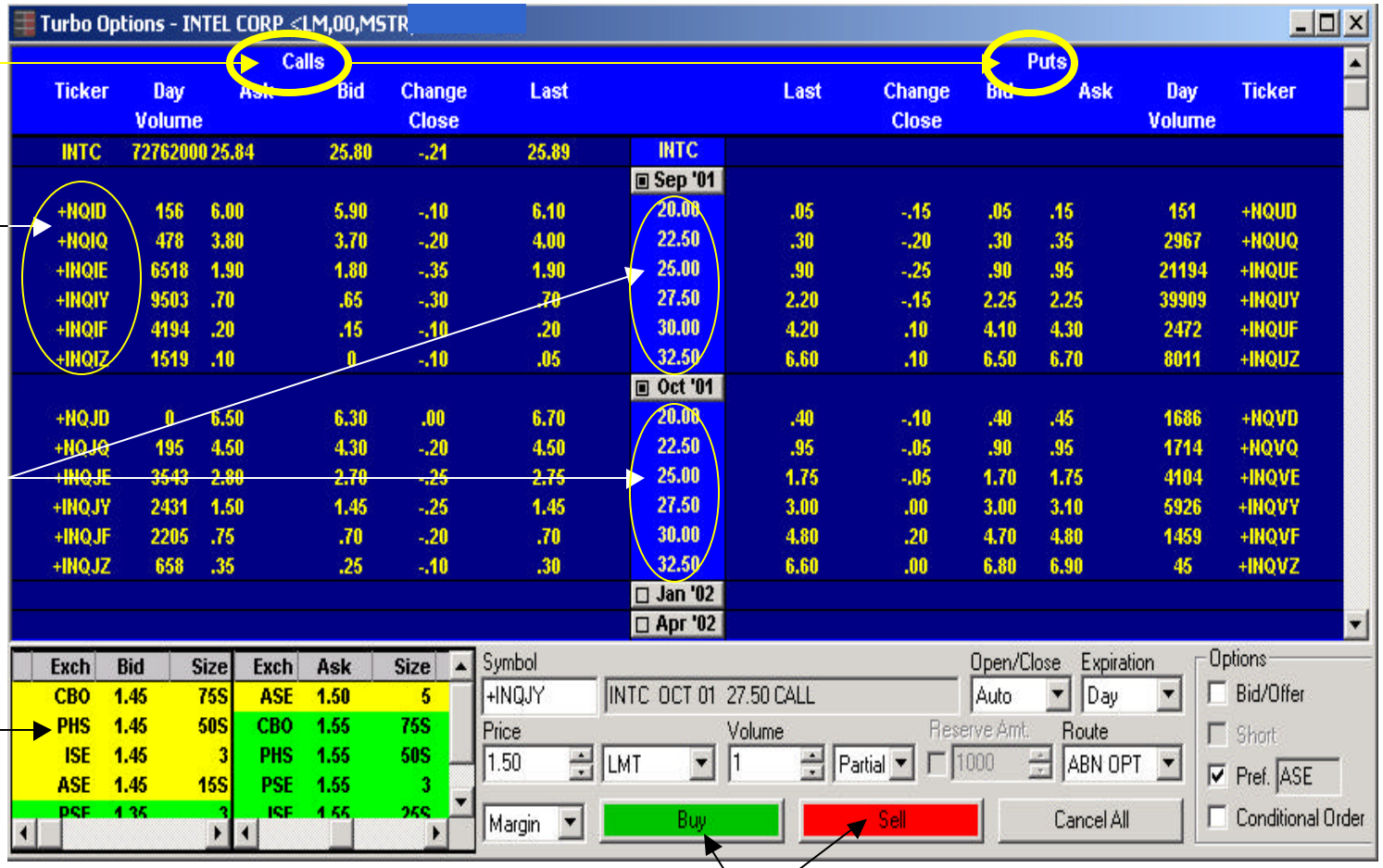
Chart Courtesy of www.mastertrader.com

Options Execution Tools

Option Type

Symbols

Strike Prices



Level II

4 pit exchanges and 1 electronic exchange

Direct-Access Execution Module

Options Execution Module Courtesy of www.mastertrader.com

PRISTINE COM

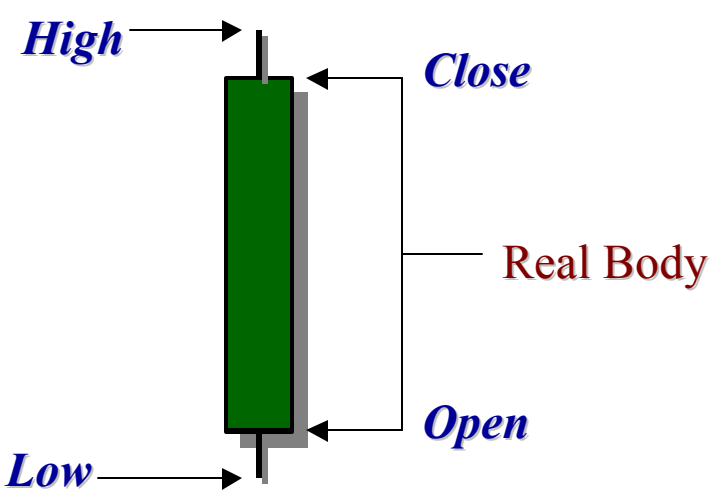
Part II

An Introduction to:

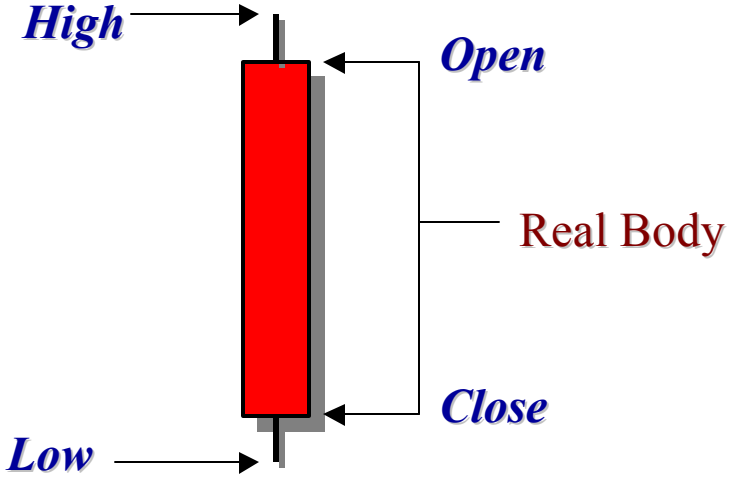
The Pristine Method™

The Ongoing Market Battle

Determining Who Won The Battle



Bulls Win



Bears Win

An Important Statistical Fact

Pristine Tip:

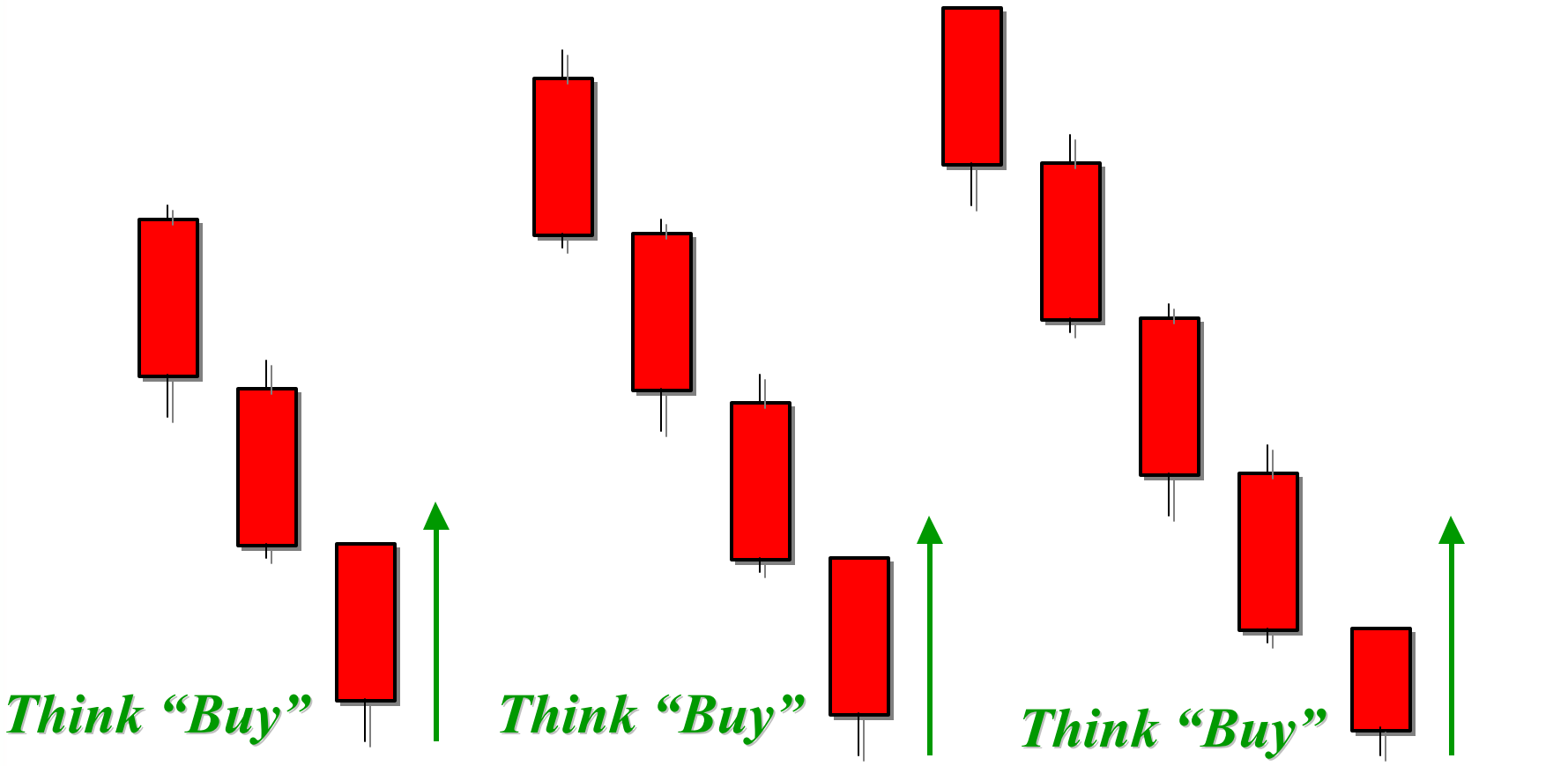
Bulls and Bears cannot consistently win more than 5 battles in a row. Each side typically surrenders to the other after 3 to 5 battles won.

However…

If the Bulls or Bears win significantly more than 5 battles in a row, *a catastrophic loss will be the price* paid for such an abnormal winning streak.

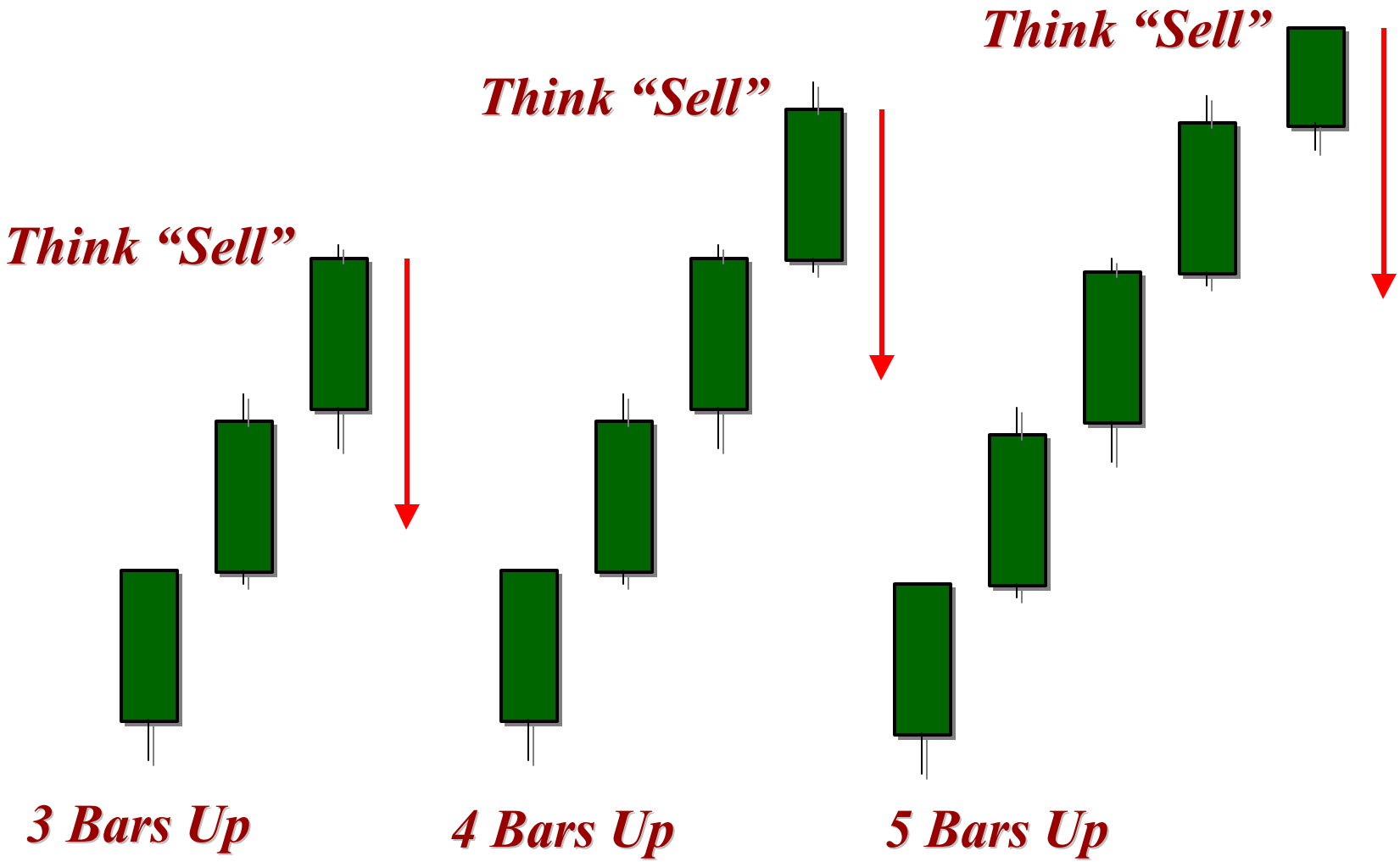
Pristine's Key Buy Concepts

When to be a Bull



Pristine's Key Sell Concept

When to Be a Bear



Count Your Way to Profits

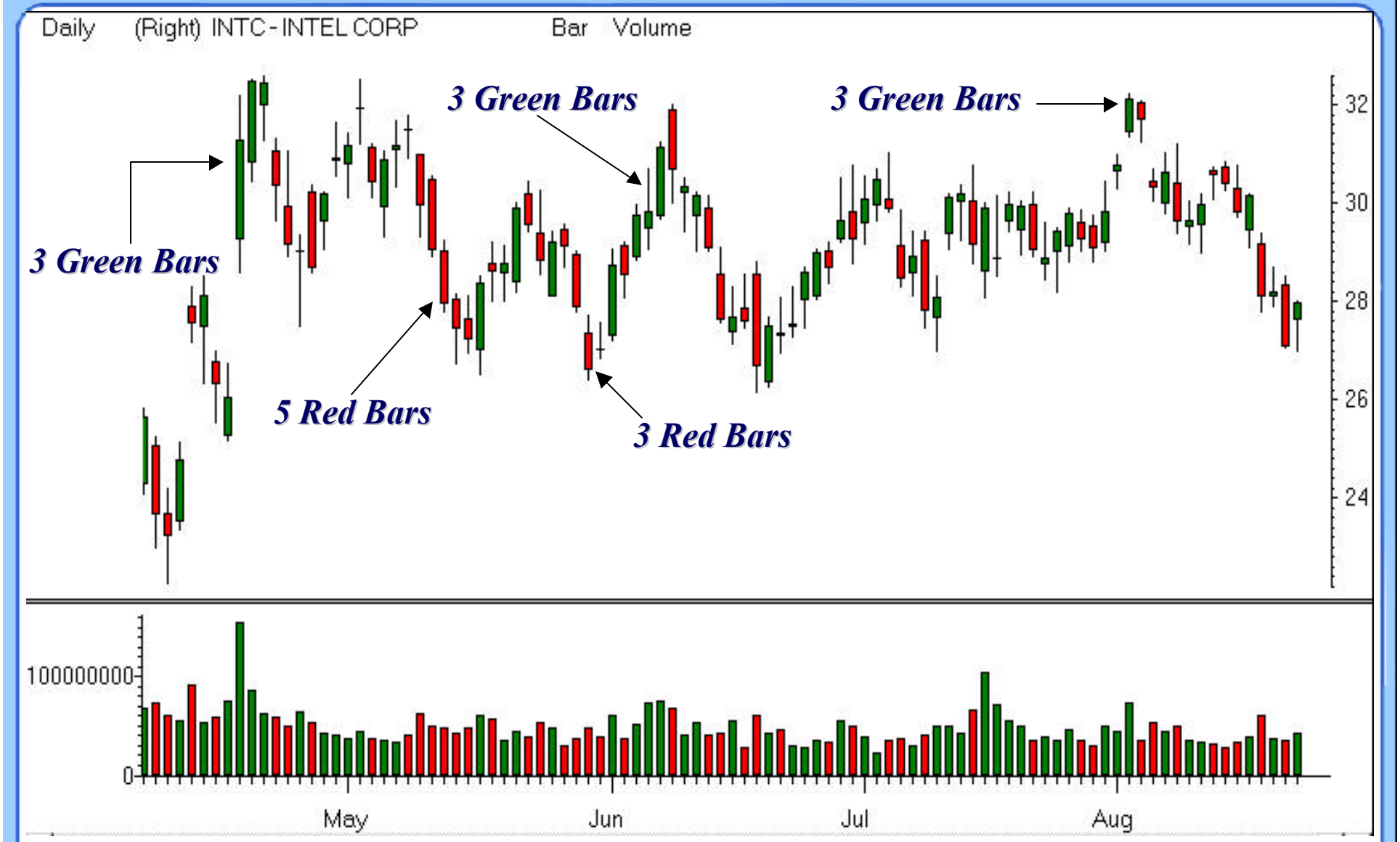


Chart Courtesy of www.mastertrader.com

Count Your Way to Profits

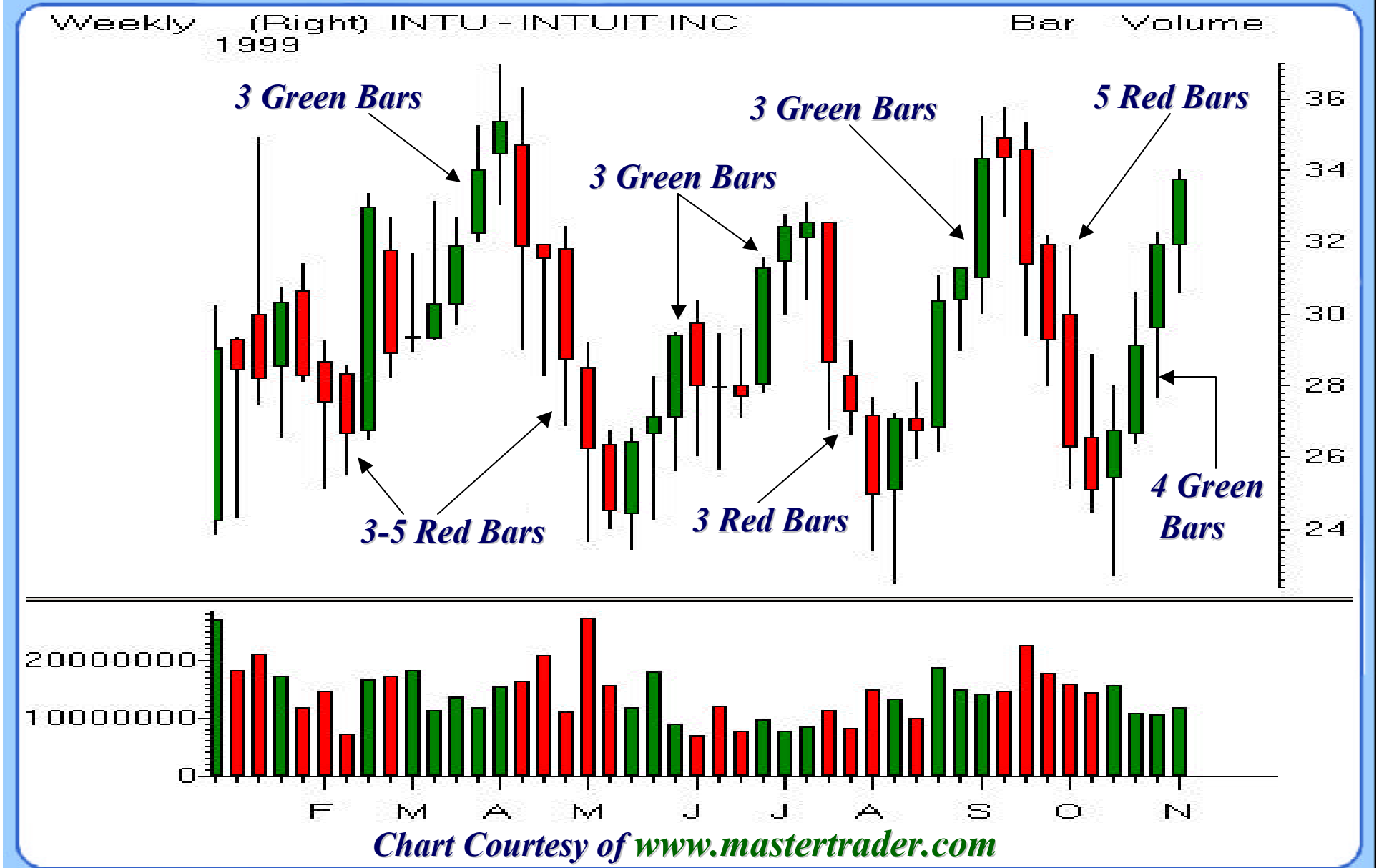


Chart Courtesy of www.mastertrader.com

An Introduction to:

The Pristine Combinations

Bull & Bear Tails

Bottoming & Topping Tails

3 or more green Bars

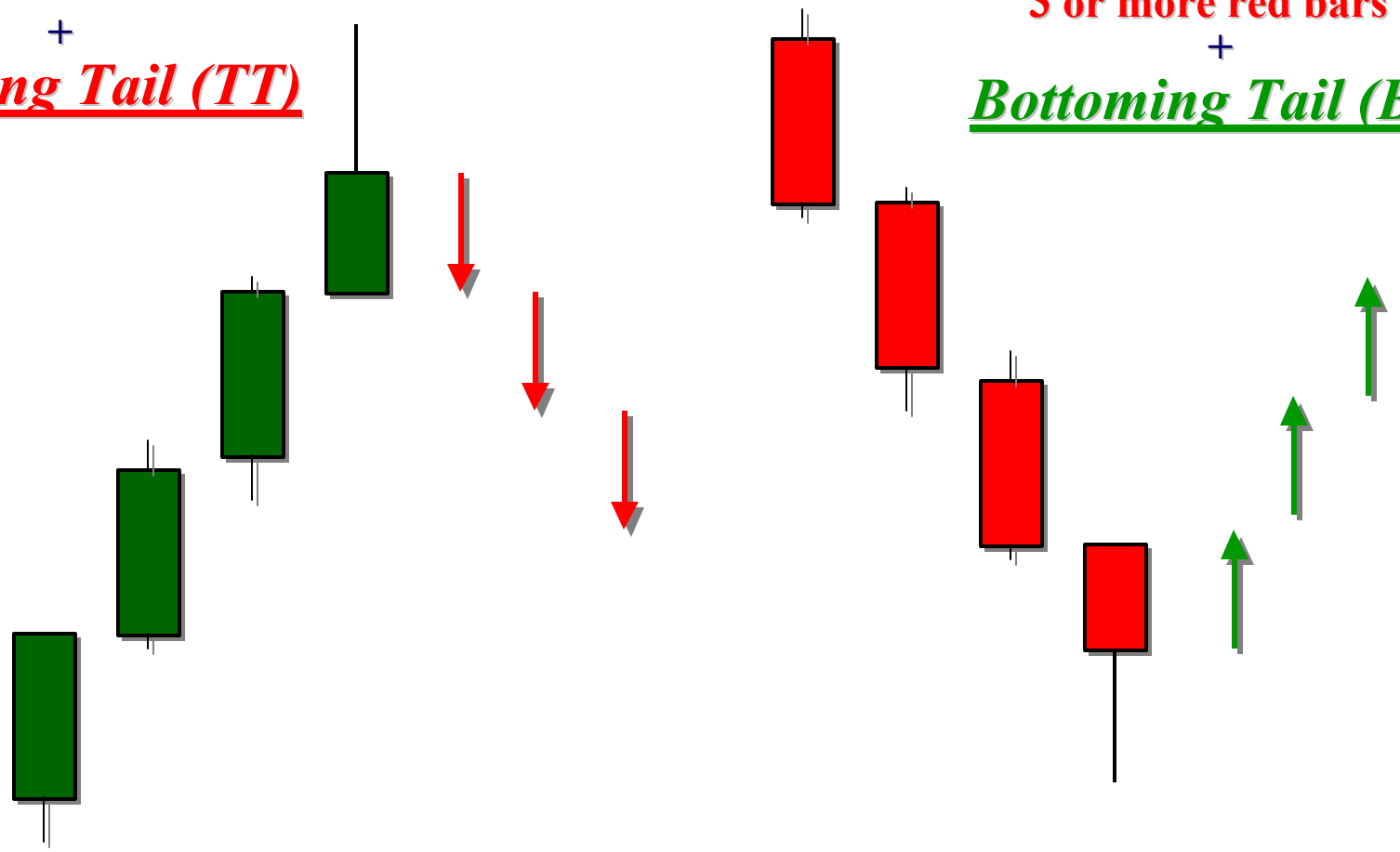
+

Topping Tail (TT)

3 or more red bars

+

Bottoming Tail (BT)



Bottoming & Topping Tails

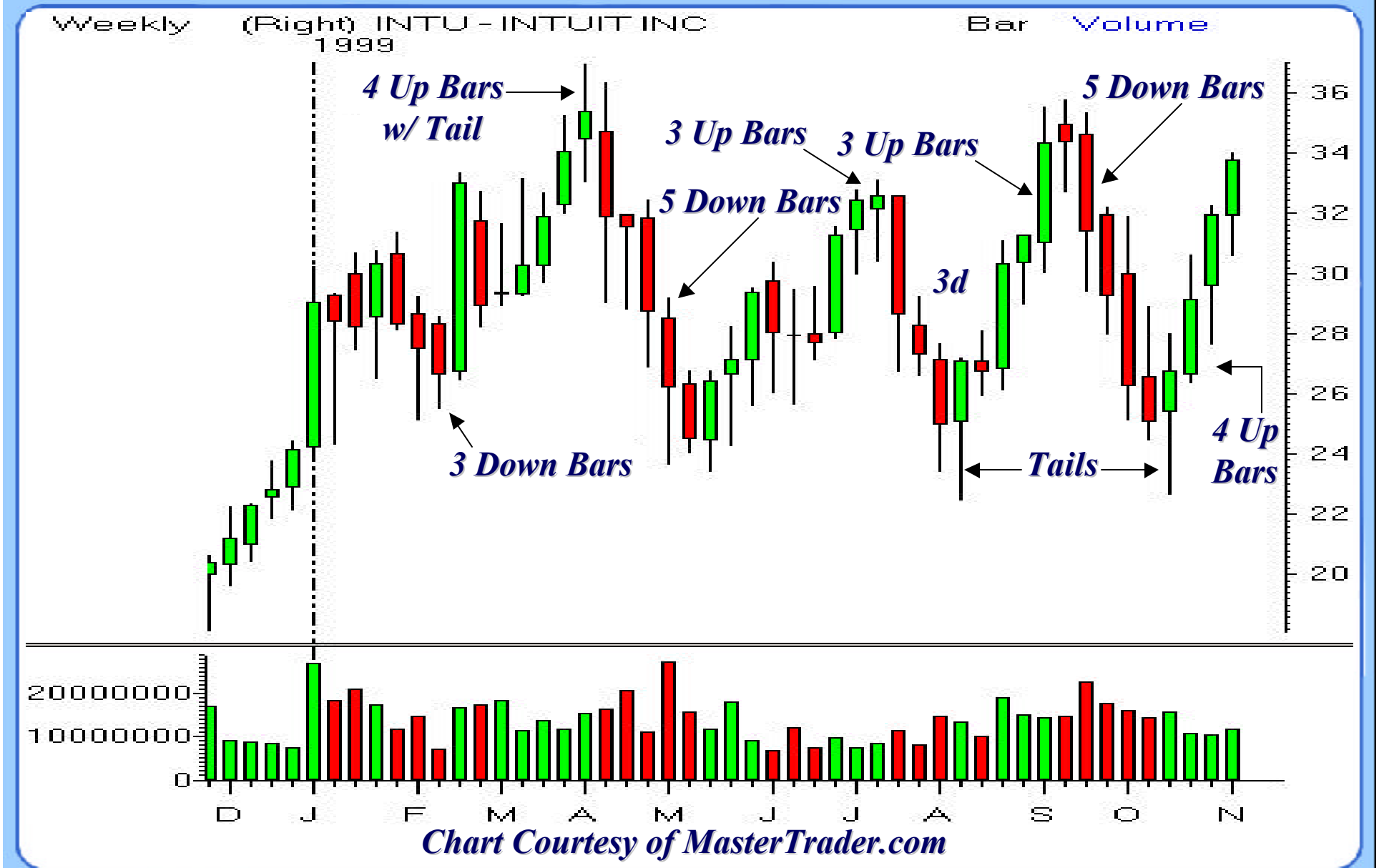


Chart Courtesy of MasterTrader.com

Bull & Bear COG

Changing of the Guard (COG)

3 or more green Bars

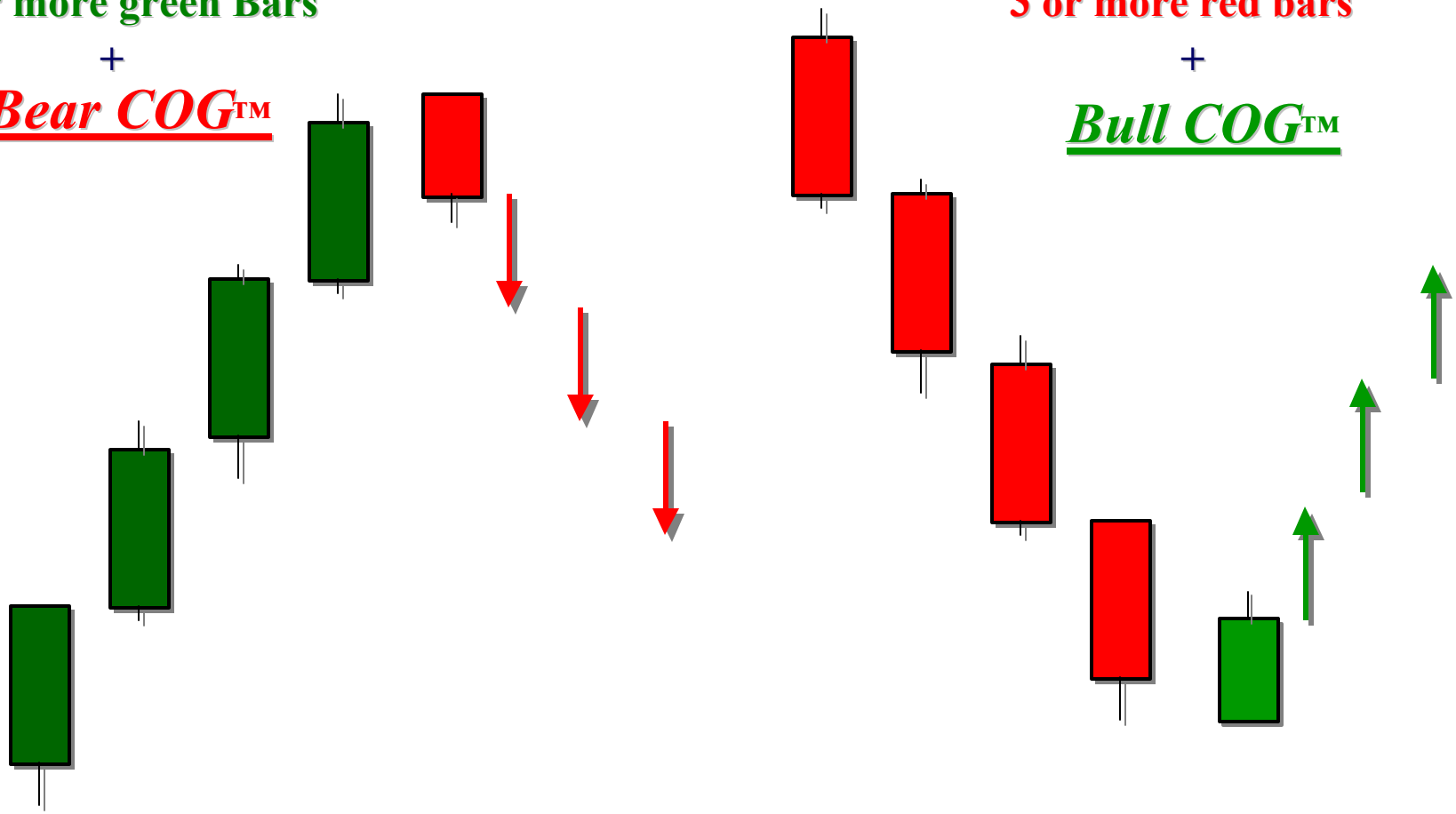
+

Bear COG™

3 or more red bars

+

Bull COG™



Bull & Bear Changing of the Guards

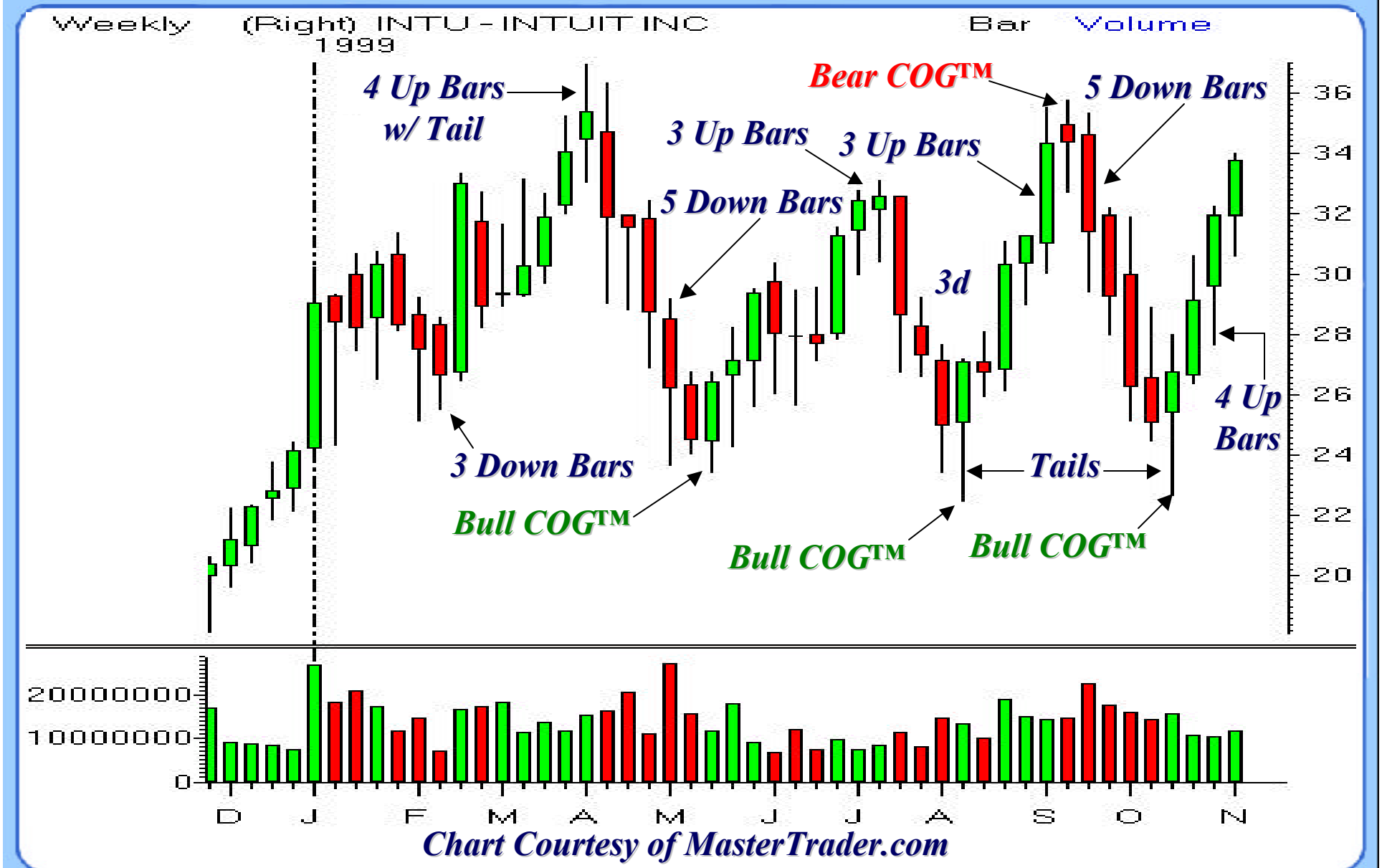


Chart Courtesy of MasterTrader.com

Pristine Trading Summary

Pristine Trading Combinations

3 to 5 Bar Buy/Sell Setups

Can happen with:

1) Topping/Bottoming Tails

and/or

2) Bull/Bear COG Setups

Powerful Trading Combinations

These Combinations can happen:

1) Outside the Upper/Lower Bollinger Band

with

2) Overbought/Oversold CCI(5) Readings

Location

Putting It All Together

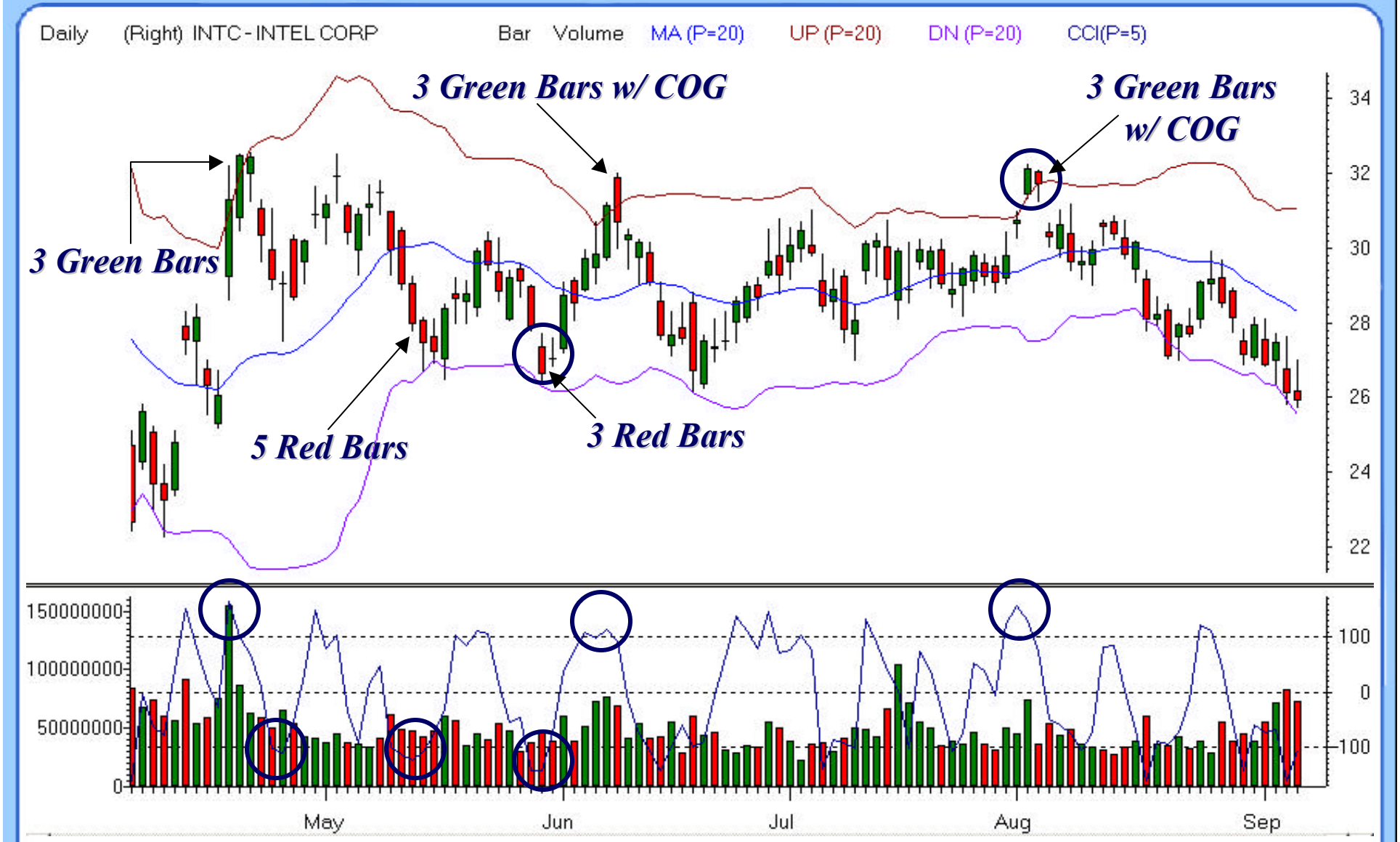


Chart Courtesy of www.mastertrader.com

PRISTINE COM

Part III

An Introduction to:

Pristine Options

What is an Option?

2001 Ferrari 360 Modena Spider

- **Suppose you're in the market for this wonderful 2001 Ferrari 360 Modena Spider**
- **You find a dealer with one in stock**
- **You wire transfer $275,000**
- **The dealer delivers the car to you**

You have just traded a commodity!

What is an Option?

2001 Ferrari 360 Modena Spider

- **Suppose you want this 2001 Ferrari 360 Modena Spider, but you prefer to purchase it four weeks from now, when you get your year-end bonus**
- **You enter into an agreement with the dealer to purchase the car for $275,000 1 month from now**

You have just traded a futures contract!

What is an Option?

2001 Ferrari 360 Modena Spider

- **You like the 360 this dealer has, *but* you ask the dealer to put the car on hold for two weeks in order to shop around.**
- **This will deny the dealer the ability to sell the car for two weeks**
- **You and the dealer agree that for a non-refundable fee of $2,000 the car will be held for two weeks, and that any time during that period you may purchase the car for $275,000.**
- **You are under no obligation to buy the car.**

You have just traded an options contract!

Options Advantages

- Limited Risk
- Calculable Risk
- Higher Levels of Leverage
- Higher Potential ROI
- Tri-directional vs. Bi-directional
- Versatile Strategies
- No Up-tick Rule Required
- Conservative or Speculative
- Less Accuracy on Entries Needed
- Guaranteed by Options Clearing Corporation

Options Disadvantages

- Time Depleting Asset
- Less Liquidity
- Wide Bid/Ask Spreads
- Slippage in Fast Markets
- Not all brokers allow options trading
- Higher Levels of Leverage
- Relatively Higher Commissions
- Delayed Openings
- Can lose despite being *right* about direction of stock

Two Types of Options Contracts

Call Options

This type of contract gives the holder (***buyer***) the right to buy ("***call away***") the underlying stock from the seller (***writer***) at a specific price (***strike***), but only for a specified amount of time (***expiry***)

Buyers (*holders*) of calls are bullish

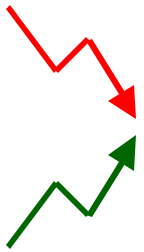
Sellers (*writers*) of calls are bearish

Put Options

This type of contract gives the holder (***buyer***) the right to sell ("***put***") the underlying stock to the seller (***writer***) at a specific price (***strike***), but only for a specified amount of time (***expiry***)

Buyers (*holders*) of puts are bearish

Sellers (*writers*) of puts are bullish



Calls in Everyday Life

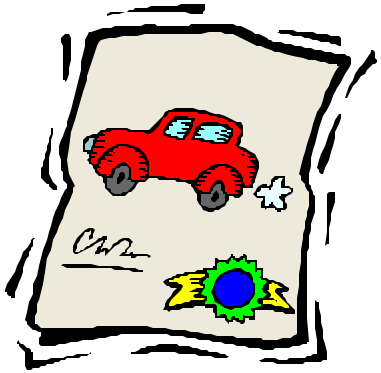
- Suppose you want to buy this quaint $25 million house, but don't know if your tax advisors will approve of the purchase.

- So, to secure the property, you enter into an agreement (*call option*) with the owner by paying $10,000 (*premium*), which gives you the right to buy the mansion for $25 million (strike price) anytime during the next 45 days (*expiry*), minus your $10,000.

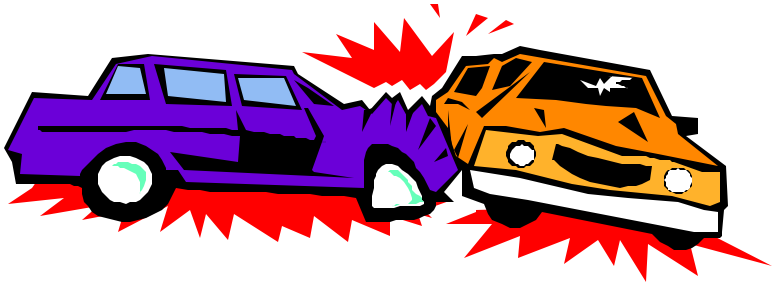
- The $10,000 (*premium*) locks in the $25 million price.
  If you choose not to buy, the owner keeps the full $10,000.
  If someone subsequently offers the owner $27 million, you can buy from the owner at $25 mil and immediately sell for $27 mil, pocketing a quick $2 million for yourself.

Puts In Everyday Life

- **Buying a put is like buying an insurance policy.**
- **The premium paid guarantees that if your car is stolen, within the agreed upon time frame *(expiry)*, you will get the full insured value *(strike price)*.**



- **Insurance companies are like option sellers, receiving Premium for assuming obligations.**
- **Put buyers pay a fee *(premium)* to *transfer risk* to put sellers.**



Common Characteristics of Puts & Calls

- The buyer purchases a right from the seller.
- The seller incurs an obligation.
- A fee or "premium" is exchanged.
- The contract is for a limited time.
- The buyer & seller have opposite profit/loss positions.
- The buyer & seller have opposite risk-return potentials.

Hedge
vs.
Speculation

Owning a Call

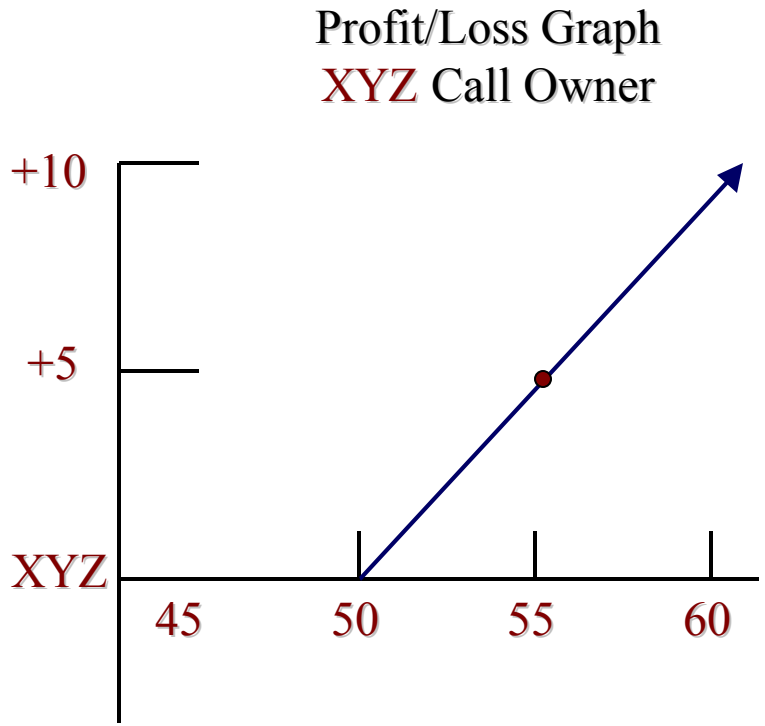
- XYZ is trading at $50.
- You have been given the right to buy XYZ at $50, free of charge, for the next 30 days.
- If XYZ stays at $50 or declines, you have no use for this right.
- If XYZ rises to $55, you can do either of the following:
- Buy XYZ for $50, then sell for a $5 profit

or

- Buy XYZ for $50 and hold

or

- Sell the right for a $5 profit

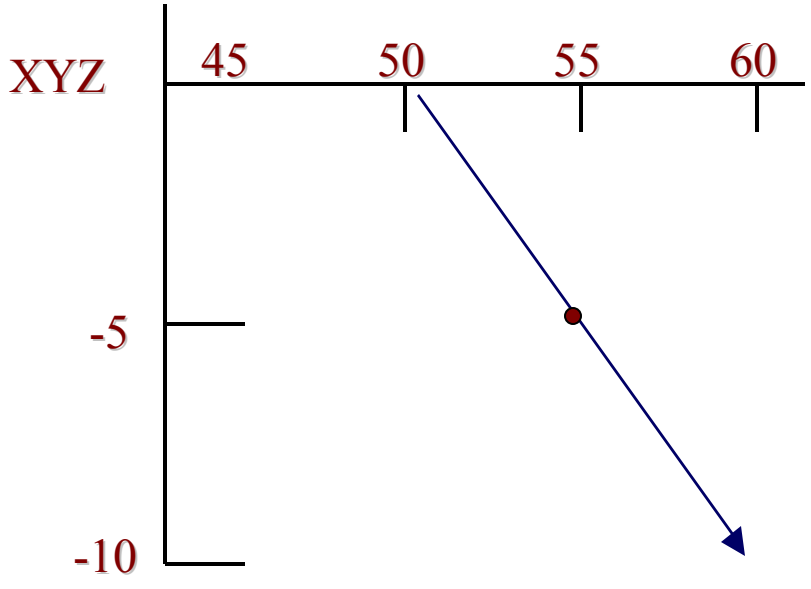


Tip: Your original right to buy XYZ is known as a Call Option, or simply a 'Call.'

Offering a Call

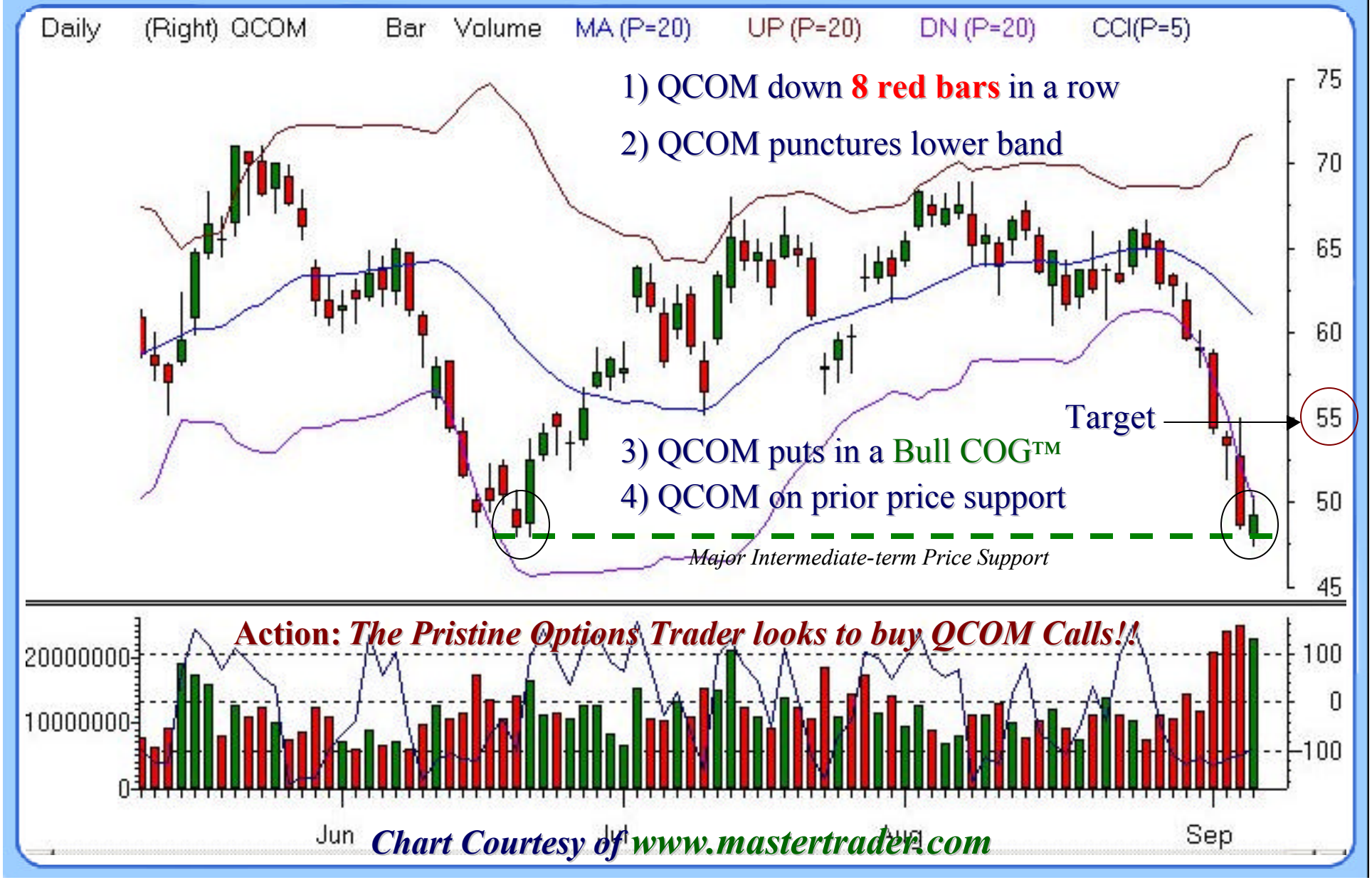
- He has given you the right to buy XYZ at $50, free of charge, for the next 30 days.
- By giving you the *right* to buy, he assumes the *obligation* to sell.
- If XYZ stays at $50 or declines, he wins and keeps XYZ.
- If XYZ rises to $55, he loses (gives up) the $5 gain to you.
- He is obligated to sell XYZ to you for $50, even though XYZ is at $55.
- If he doesn't own XYZ, he will have to buy XYZ at $55 and deliver it to you at $50.

Profit/Loss Graph
XYZ Call Seller



Tip: ***As the owner of the call, your potential gain is exactly his potential loss.***

Example of Call Purchase



Choosing Your Strike

- **AT-THE-MONEY (ATM)** options have a strike price at or near the current price of the stock (QCOM $50).

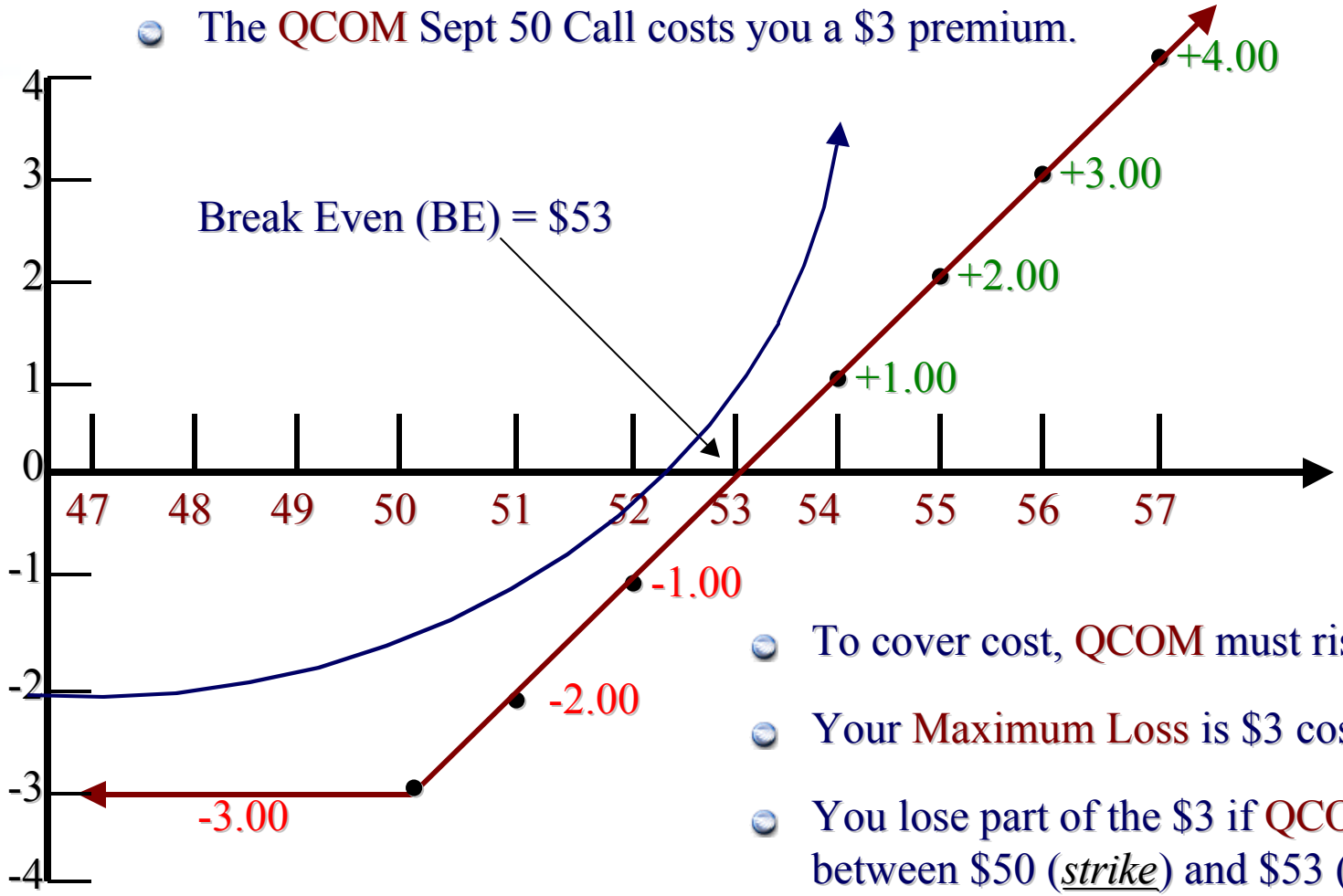
- **IN-THE-MONEY (ITM)** options have Intrinsic Value. For Call options, ITM options have strike prices below the current price of the stock. For Put options, ITM options have strike prices above the current price of the stock (QCOM $45 Call).

- **OUT-OF-THE-MONEY (OTM)** options have no Intrinsic Value. All the value of the option is time value. For **call** options, OTM options have strike prices above the current price of the stock. For **Put** options, OTM options have strike prices below the current price of the stock. (QCOM $55 Call).

Note: The strike you select depends on your risk tolerance and on how bullish/bearish you are.

Buying a QCOM (ATM) Call

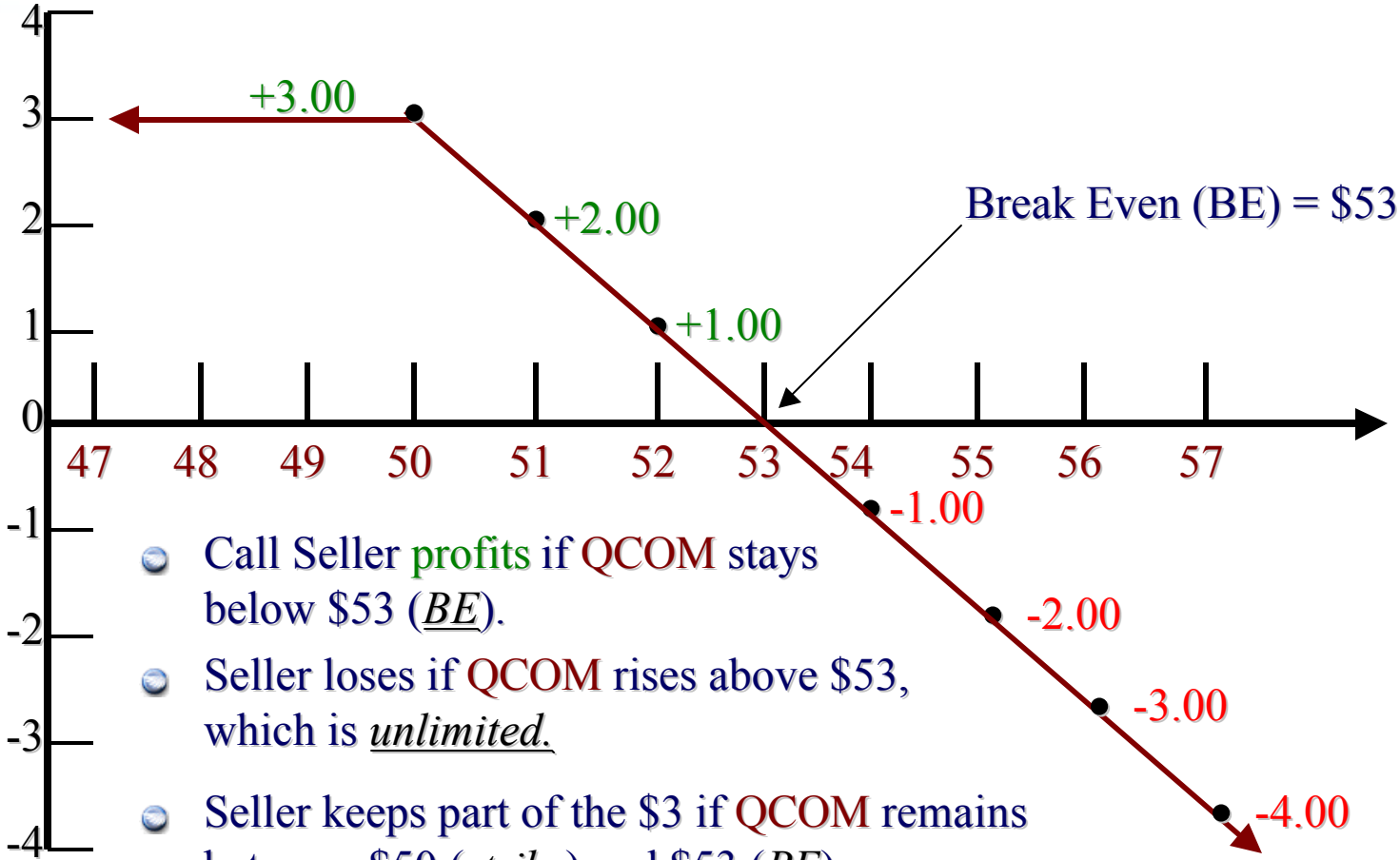
- The QCOM Sept 50 Call costs you a $3 premium.



- To cover cost, QCOM must rise to $53.
- Your Maximum Loss is $3 cost of call.
- You lose part of the $3 if QCOM remains between $50 (*strike*) and $53 (*BE*).
- You profit above $53, which is *unlimited.*

Selling a QCOM (ATM) Call

- The Seller of the QCOM Sept 50 Call receives your $3 premium.



- Call Seller profits if QCOM stays below $53 (*BE*).
- Seller loses if QCOM rises above $53, which is *unlimited.*
- Seller keeps part of the $3 if QCOM remains between $50 (*strike*) and $53 (*BE*).
- Seller keeps Maximum Gain ($3) if QCOM remains at $50 (strike) or below.

Summarizing Call Options

- A call is the ***right*** to buy the underlying asset (stock) at a specified price (strike) for a specified period of time (expiry).
- The call buyer pays a premium for the ***right***, but ***not the obligation***, to buy the underlying asset (stock).
- The call seller receives premium and assumes the ***obligation*** to sell the underlying (stock) at the call buyer's discretion.

Summary

- The call contract is for a limited time period.
- A call is used to capitalize on upside market movement w/ leverage.
- A call serves as an alternative to buying the underlying stock to limit downside exposure.
- Buyers have unlimited profit; sellers have maximum gain.

Example of Put Purchase

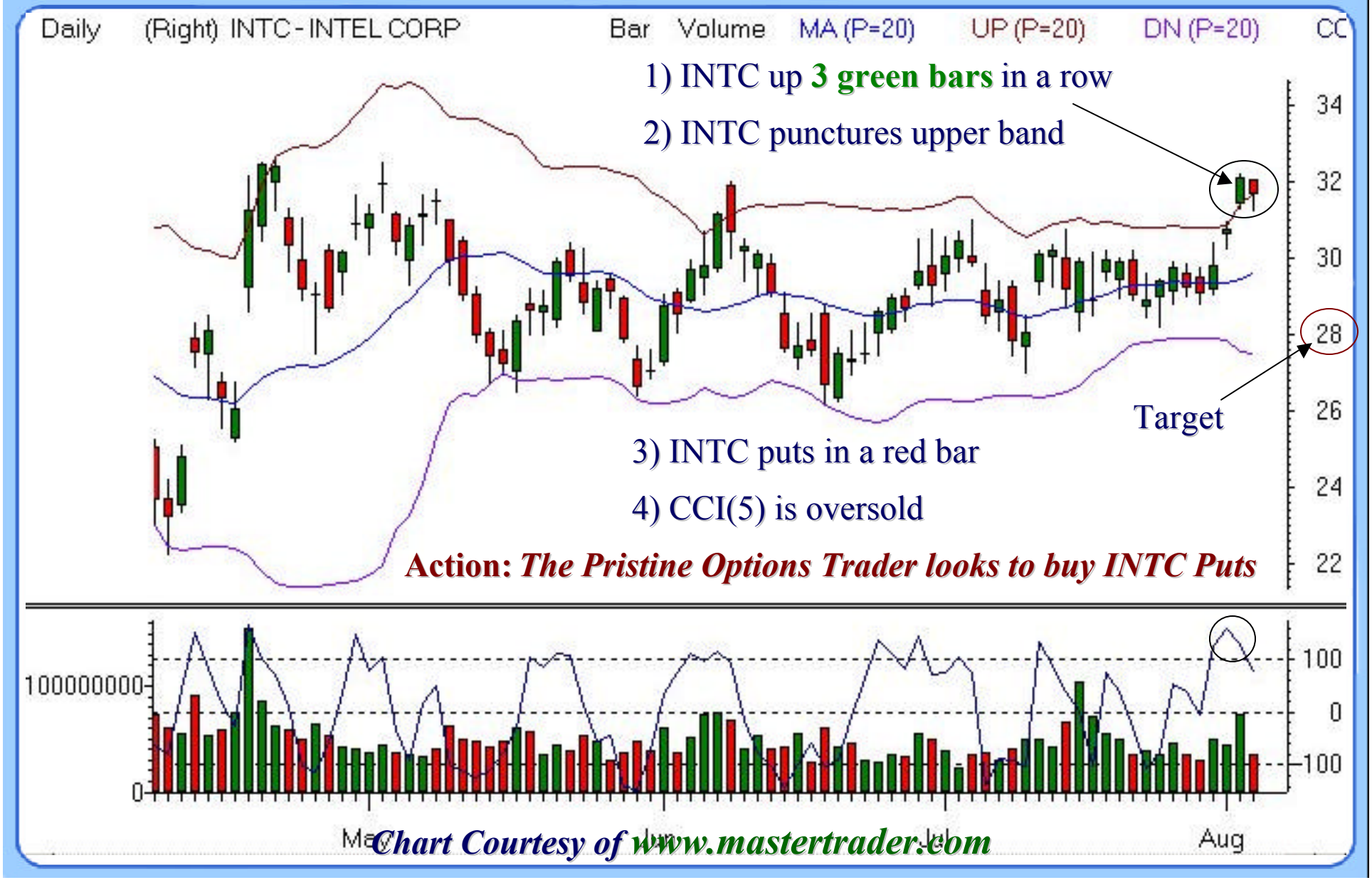
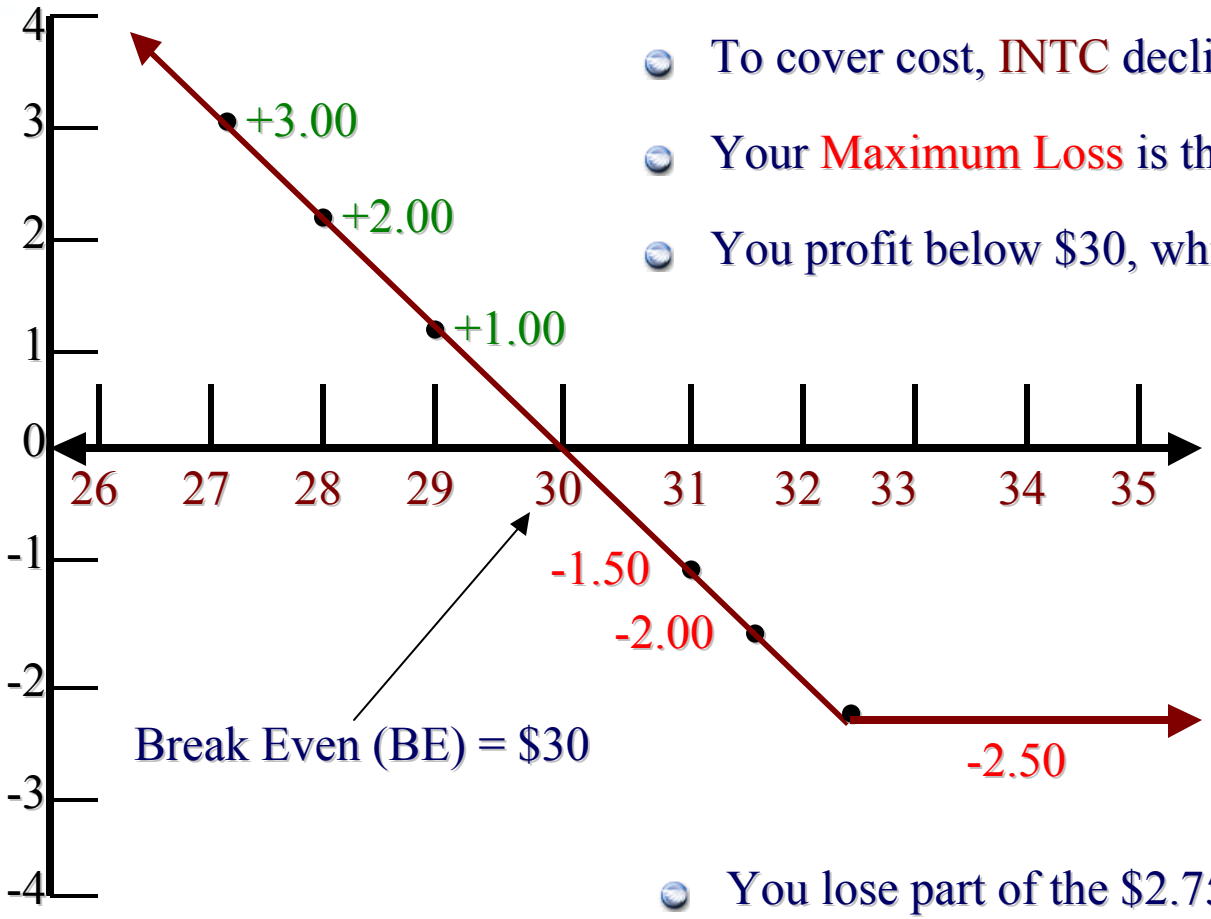


Chart Courtesy of www.mastertrader.com

Buying an INTC (ATM) Put

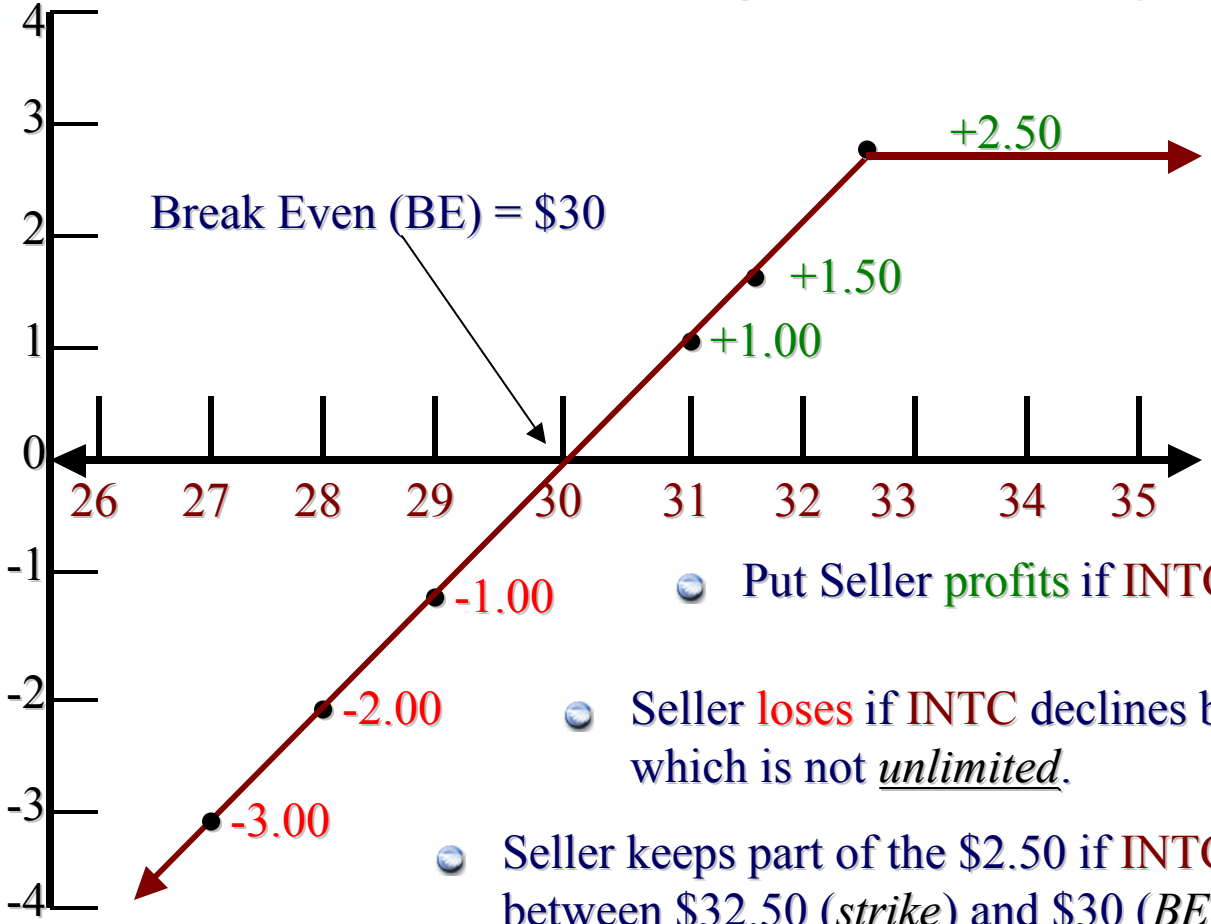
- INTC Aug 32.50 Put costs you $2.50.
- To cover cost, INTC declines to $30 (*BE*).
- Your Maximum Loss is the $2.75 cost of put.
- You profit below $30, which is not *unlimited*.



- You lose part of the $2.75 if INTC remains between $32.50 (*strike*) and $30 (*BE*).

Selling an INTC (ATM) Put

- The Seller of the INTC Aug 32.50 Put receives your $2.50 premium.



- Put Seller profits if INTC stays above $30 (*BE*).
- Seller loses if INTC declines below $30, which is not *unlimited*.
- Seller keeps part of the $2.50 if INTC remains between $32.50 (*strike*) and $30 (*BE*).
- Seller keeps Maximum Gain ($2.50) if INTC remains at $32.50 or above.

Summarizing Put Options

- A put is the ***right*** to sell the underlying asset (stock) at a specified price (strike) for a specified period of time (expiry).
- The put buyer has the ***right***, but ***not the obligation***, to sell the underlying asset (stock).
- The put seller has the ***obligation*** to buy the underlying (stock) at the put buyer's discretion.

Summary

- The put contract is for a limited time period.
- A put is used to capitalize on downside market movement.
- A put serves as a safer alternative to selling (shorting) the underlying stock, as it limits the potential loss.

Option Matrix

CALLS

Buyers (Bullish)

- Pay a premium for right to buy stock
- Buy to open (**long**)
- Owner/holder of asset
- Max gain = unlimited
- Max risk = premium paid

Sellers (Bearish/Neutral)

- Receive premium for the obligation to sell stock
- Sell to open (**short**)
- Max gain = premium received
- Max risk = unlimited unless covered

PUTS

Buyers (Bearish)

- Pay a premium for right to sell stock
- Buy to open (**long**)
- Owner/holder of asset
- Max gain = strike price – premium paid
- Max risk = premium paid

Sellers (Bullish/Neutral)

- Receive premium for the obligation to buy
- Sell to open (**short**)
- Max gain = premium received
- Max risk = strike price – premium received

PRISTINE.COM

Part IV

An Introduction to:

Options Pricing

3 Determinates of Price

- **A Change in the *Underlying***
- **The Passage of *Time***
- **A Change in *Volatility***

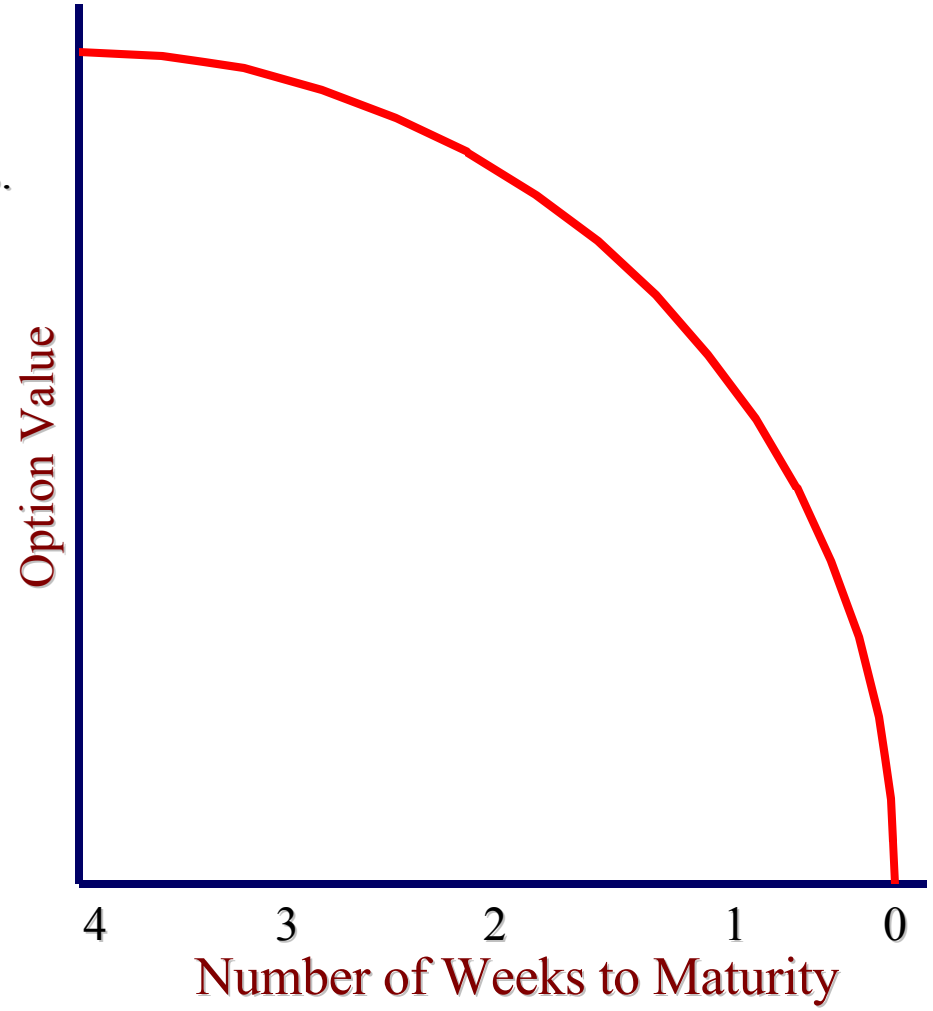
- Options theory is able to calculate the exposure to these three variables.
- The terms that apply to the calculations are called the Greeks.

The Four Greeks

- **Delta**
- **Theta**
- **Gamma**
- **Vega**

Time Premium Decay

- Options are time depleting assets.
- Time premium will decay as time passes.
- The closer the option is to maturity, the more rapid the time premium decay.
- Time premium is greatest for at-the-money options.
- Deep in(out)-of the money options have small premiums.
- Decay accelerates rapidly during the last 15 days.



The Greeks: Delta

Delta:

- It is the amount that an option changes with respect to a small change in the underlying.
- Deep, in-the-money options will often change one for one with the underlying. In this case, the option's *delta* would be 1.00.
- At-the-money options generally change price at half the rate, and therefore have *deltas* of .50.
- Options so far out-of-the-money are often considered worthless, and therefore have deltas close to 0.00. This means the option will not move in price, no matter what the underlying does.

Pristine Tip: Think of delta as the probability of an option expiring in-the-money.

If an option has a delta of .10, it has a 10% chance of expiring in-the-money.

2 strikes in the money = high Delta.

Greeks: Gamma, Theta & Vega

Gamma:

- Quantifies the rate of change of the delta with respect to a change in the underlying.
- Measures how quickly or slowly delta responds to a change in the underlying.

Theta:

- It is the amount that the option decays in one (1) day.
- A writer (seller) receives income from time decay and therefore has '*positive theta.*' A buyer incurs an expense from time decay and therefore has '*negative theta.*'

Vega:

- It is the amount that an option changes if the '*implied volatility*' changes by one percentage (1%) point.
- A long options position profits from an *increase* in implied volatility, and therefore has '*positive vega.*' A short options position profits from a decrease in implied volatility, and therefore has '*negative theta.*'

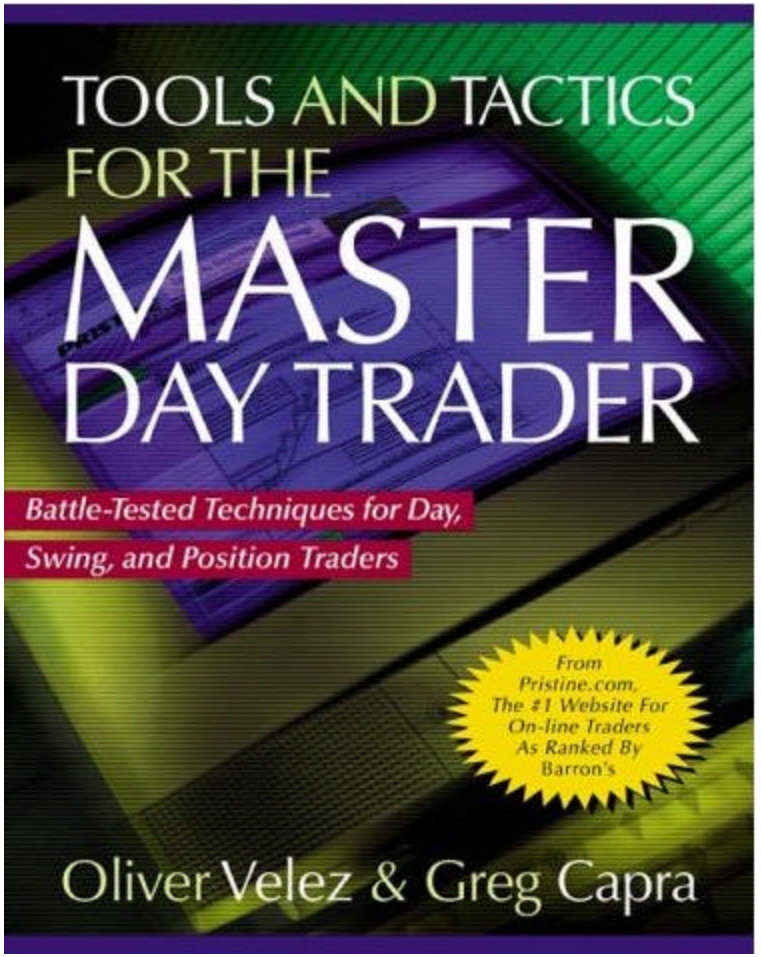
Playing the NASDAQ w/ Options

Chart Courtesy of www.mastertrader.com

Tools & Tactics – A Must Read

A Japanese proverb says, "If you wish to know the road, inquire of those who have traveled it." The authors of Tools and Tactics for the Master Trader clearly know the road. Their unique insights, trading tactics and powerful tools, so enjoyably presented, make this a book that belongs on every trader's shelf.

Steve Nison, CMT - Author of Japanese Candlestick Charting Techniques



www.pristine.com

Ranked #1
Trading Web Site By:
BARRON'S Online

Forbes.com
Best Of The Web Review

CNBC

FOX NEWS channel

Pristine Seminars

Pristine Educational Events

The Pristine Method™ | Free Events | Online Seminars | 1 & 2 Day Seminars | Mentorship Programs | 2 Week Boot Camps | In-House Training | International Seminars | Testimonials

PRISTINE Educational Events

FULL SCHEDULE OF ALL PRISTINE EVENTS: AUGUST | SEPTEMBER | OCTOBER

CALENDAR OF EVENTS

SEMINAR DESCRIPTIONS

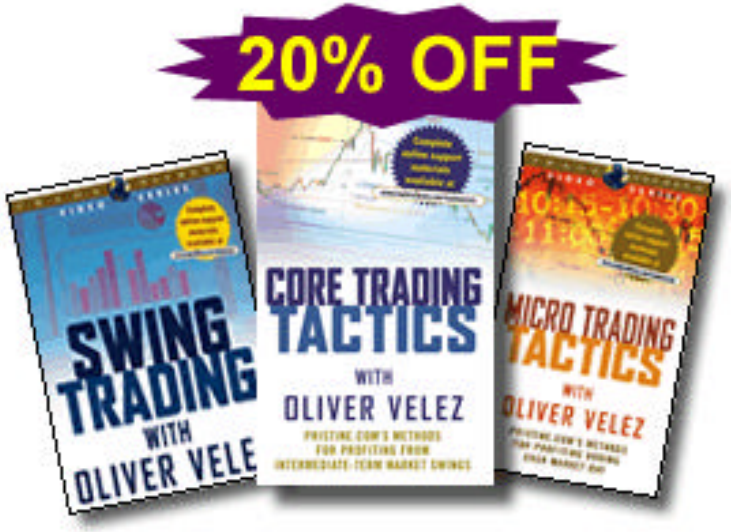
1 & 2 DAY SEMINARS (DOMESTIC)

DATE	EVENT (DESCRIPTION)	LOCATION	PRICE	INFO	REGISTER
August 10	Developing a Master Trading Plan	White Plains, NY	FREE	More Info	Register
August 11	Trading Fundamentals - The First Step Towards Trading Mastery	White Plains, NY	$695	More Info	Register
August 12 - 13	Intraday Trading Tools and Tactics	White Plains, NY	$1,995	More Info	Register
August 23	Developing a Master Trading Plan	Irvine, CA	FREE	More Info	Register
August 24 - 25	Trading The Pristine Method™	Irvine, CA	$1,995	More Info	Register
August 26 - 27	Intraday Trading Tools and Tactics	Irvine, CA	$1,995	More Info	Register
September 7	Developing a Master Trading Plan	Miami, FL	FREE	More Info	Register
September 8 - 9	Trading The Pristine Method™	Miami, FL	$1,995	More Info	Register
September 14	Developing a Master Trading Plan	San Mateo , CA	FREE	More Info	Register
September 15 - 16	Trading The Pristine Method™	San Mateo, CA	$1,995	More Info	Register
January 14	The Simple Art of Trading Using The Pristine Method™	Ft. Lauderdale, FL	$995	More Info	Register

Pristine Video Collection

For this and other Pristine videos, visit:

http://www.pristine.com/newvideo_core.htm



Mastertrader.com

MASTER TRADER.COM
Empowering the Active Trader

FREE DSL — Trade Like A Pro with: real-time level 2 quotes and real-time charts

Home | Account Info | Fee Schedule | Download | Contact Us | Education | Training Login | Funding Instructions | Open Account

Open Account

Choose language: English Go

Master your trading performance with:

- FREE Real-Time Nasdaq Level II quotes*
- FREE Real-Time charting*
- Commissions as low as $9.95
- Access to Market Makers & ECNs
- Stop and Trailing Stop orders
- Fast Executions**
- Online Options Trading Available
- Free Online Software Training

Download Now...

Empowering the Active Trader

Open trading account today

TOLL FREE : 1-866-400-2966
INTERNATIONAL : 1-914-422-2966

*INDICATED SERVICES ARE FREE WITH ACCOUNT ACTIVITY OF 50 OR MORE TRADES IN ONE MONTH. A ROUND TRIP EQUALS TWO TRADES. **MARKET VOLATILITY AND HIGH VOLUME MAY DELAY SYSTEM ACCESS AND TRADE EXECUTION.
"THE RISK OF LOSS IN ELECTRONIC DAY TRADING CAN BE SUBSTANTIAL. THEREFORE, YOU SHOULD CAREFULLY CONSIDER WHETHER SUCH TRADING IS SUITABLE FOR YOU IN LIGHT OF YOUR CIRCUMSTANCES AND FINANCIAL RESOURCES."

Mastertrader Feature

Mastertrader Feature

Mastertrader Contact Info

New Accounts
1-866-400-2966
accounts@mastertrader.com

Customer Support
1-866-400-2966
support@mastertrader.com

About Mastertrader

Mastertrader.com is a technology driven, electronic trading firm providing the latest in advanced trading tools. As a client, you can trade NASDAQ, AMEX and NYSE stocks electronically via **The Island ECN (ISLD), Archipelago ECN (ARCA), SOES (Small Order Execution System) and ISI (a Super Dot equivalent).** Online Options trading is also available. Clients can choose to route options orders to various option exchanges: **ASE, CBO, PSE, and PHS.**

Clients of **Mastertrader.com**, have the power to trade like a pro with real-time level 2 quotes, real time charts, a competitive commission structure and access to market makers and ECN's (Electronic Communication Networks). Using RealTick, Townsend Analytics Ltd. proprietary trading software, we give active traders the ability to view market information in real-time and enter orders directly on their computers.

More

Home | Account Info | Fee Schedule | Download | Contact Us | Education | Training Login | Funding Instructions | Open Account

Pristine's Options Manual is available for download at:

www.pristine.com/options.htm

© Copyright 1995-2001, Pristine.com. All rights reserved.

COPYING AND OR ELECTRONIC TRANSMISSION OF THIS DOCUMENT
WITHOUT THE WRITTEN CONSENT OF PRISTINE.COM IS A VIOLATION OF THE COPYRIGHT LAW